2982

No. 15247

United States
Court of Appeals
for the Ninth Circuit

LOUIS L. GOWANS AND HELEN T. GOWANS,
Husband and Wife,

Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

Transcript of Record

Petition to Review a Decision of the Tax Court of the United States

Phillips & Van Orden Co., 870 Brannan Street, San Francisco, Calif.—12-21-56

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[Clerk's Note: When deemed likely to be of an important nature, errors or doubtful matters appearing in the original certified record are printed literally in italic; and, likewise, cancelled matter appearing in the original certified record is printed and cancelled herein accordingly. When possible, an omission from the text is indicated by printing in italic the two words between which the omission seems to occur.]

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APPEARANCES

FRANK D. PADGETT,
312 Castle & Cooke Bldg.,
Honolulu, Hawaii,

For the Petitioner.

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Washington 25, D. C.

For the Respondent.

The Tax Court of the United States

Docket No. 50427

LOUIS L. GOWANS and HELEN T. GOWANS, Husband and Wife,

Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

DOCKET ENTRIES

1953

Sept. 4—Petition received and filed. Taxpayer notified. Fee paid.

Sept. 8—Copy of petition served on General Counsel.

Sept. 4—Request for Circuit hearing in Honolulu, T.H., filed by taxpayer. 9/15/53—Granted.

Oct. 26—Answered filed by General Counsel.

Nov. 5—Copy of answer served on taxpayer—Honolulu, T.H.

1954

May 7—Hearing set July 9, 1954, Honolulu, T.H.

May 27—Hearing changed to July 15, 1954, Honolulu, T.H.

July 22—Hearing had before Judge LeMire on the merits; Appearance of Frank D. Padgett and Stipulation of Facts filed; Brief due Sept. 22, 1954; Respondent's Brief due Nov. 22, 1954 and Petitioner's reply due Dec. 22, 1954.

Aug. 30—Transcript of Hearing 7/22/54 filed.

1954

Sept. 17—Brief filed by taxpayer. Copy served.

Nov. 22—Motion for extension to Feb. 20, 1955 to file answer brief filed by General Counsel. 11/23/54—Granted.

1955

Feb. 21—Motion for extension to Mar. 7, 1955 to file answer brief filed by General Counsel. 2/23/55—Granted.

Mar. 3—Answer Brief filed by General Counsel.

Mar. 30—Motion for extension to April 26, 1955 to file reply brief, filed by taxpayer. 3/30/55 —Granted.

Apr. 11—Reply Brief filed by taxpayer. Copy served.

1956

May 31—Memorandum findings of fact and opinion filed. Judge LeMire. Decision will be entered under Rule 50. Served 6/1/56.

July 3—Agreed computation filed.

July 5—Decision entered, Judge LeMire, Div. 5. Served 7/6/56.

July 20—Petition for Review by U. S. Court of Appeals for the 9th Circuit, filed by petitioner; with attached, Designation of Record, Statement of Points on Appeal, Statement of Service, and Notice, filed by petitioner.

The Tax Court of the United States

Docket No. 50427

LOUIS L. GOWANS and HELEN T. GOWANS (Husband and Wife),

Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITION

The above-named petitioners hereby petition for a redetermination of the deficiencies set forth by the Commissioner of Internal Revenue in his notice of deficiency (bureau symbols ADC-Ap:LA, SF:LVH: DRU-150-D) dated June 5, 1953, and as a basis of their proceeding allege as follows:

I.

The petitioners are individuals, husband and wife, and reside at 2785 Round Top Drive, Honolulu, Hawaii. Their joint income tax returns for the calendar and taxable years 1948, 1949, and 1950, were filed with the Collector of Internal Revenue, District of Hawaii, at Honolulu, Hawaii.

II.

The notice of deficiencies, a copy of which is attached and marked Exhibit A, was mailed to the petitioners on June 5, 1953.

income for each of the calendar years 1948, 1949, and 1950, statutory depletion of a natural deposit.

F. The Commissioner of Internal Revenue erred in determining that there are deficiencies of $2,784.52, $2,016.86, and $4,759.92, in the petitioners' returns of income taxes for the calendar years 1948, 1949, and 1950, respectively, and in failing to determine, instead, that the petitioners overpaid their liabilities for income taxes for the three years aforesaid, in the amounts of $1,656.92, $1,657.22, and $2,827.70 respectively.

V.

The facts upon which the petitioners rely as the basis of this proceeding are as follows:

A. The petitioners are husband and wife, citizens of the United States, and residents of the City and County of Honolulu, Territory of Hawaii.

B. Petitioners always have computed their net incomes upon the bases of cash receipts and disbursements and calendar year.

C. Throughout the period begun January 1, 1945, and ended December 31, 1950, as well as prior and subsequent to said period, each of the petitioners has been employed full time by the Honolulu Gas Company, Limited, a public utility, in Honolulu, Hawaii.

D. The petitioners, throughout their lives as husband and wife, have combined their services, earnings, and capital. Their investments have been joint. Furthermore, during the period begun June 1, 1945,

and ended June 30, 1949, there was in effect in the Territory of Hawaii a Community Property Law. The said law provided that all property, both real and personal, including the earnings of the husband and the earnings of the wife and including rents, issues, income and other profits of the separate property of the husband and the wife, acquired by the husband or by the wife after marriage or on or after the effective date of the said Act, whichever was the later, should be community property of the husband and wife, and each was vested with an undivided one-half interest therein. The respective interests of the husband and the wife in such community property constituted present, existing, and equal interests and arose as an incident of marriage.

E. Under date of December 28, 1932, the petitioners, as joint tenants, purchased from A. V. Gear, under an agreement of sale, a parcel of land, in consideration of $7,500.00, Lot 824, Makiki Round Top Lots, City and County of Honolulu, containing an area of three (3) acres, more or less, for use as their homesite. A. V. Gear had acquired the said lot under the Homestead Laws of the Territory of Hawaii, Land Patent Grant Number 6815, under date of February 20, 1917. Gear died testate before the purchase price had been paid in full, and devised Lot 824, subject to the Agreement of Sale, to his wife. The widow, Addie B. Gear, died testate under similar circumstances and devised Lot 824, subject to the Agreement of Sale, to her children. The Gears' children, Harold B. Gear and Hazel Gear

Raseman, after receipt of payment in full of account of the sale price of said homesite, deeded to the petitioners, on July 5, 1936, Lot 824, aforesaid.

F. Petitioners sold 10,018 square feet of Lot 824, aforesaid, facing Round Top Drive, by unrecorded agreement of sale dated April 30, 1946. Upon payment, during 1947, of the final installment of the consideration of $10,000.00, petitioners executed on October 8, 1947, and delivered to the purchasers, a deed.

G. During September, 1937, the petitioners began the construction upon Lot 824, Makiki Round Top Lots, at 2785 Round Top Drive, of their home, which they have occupied continuously since its erection. An extension thereto was begun in November, 1944.

H. On February 24, 1938, the petitioners purchased at public auction, under Special Sale Agreement No. 1762, in consideration of $8,150.00, in accordance with the provisions of section 73 of the Hawaiian Organic Act and Chapter 54, Revised Laws of Hawaii, 1935, Lot No. 822, Makiki Round Top Lots, City and County of Honolulu, containing two and ninety-seven hundredths (2.97) acres of land. Lot 822 adjoins Lot No. 824, both aforesaid.

I. Honolulu Construction & Draying Company, Limited, a Hawaiian corporation engaged in business as a general construction contractor and manufacturer of tile, in the City and County of Honolulu, hereinafter referred to as "HC&D," had need for

black sand for the manufacture of tile products and for other purposes incident to the prosecution of World War II. HC&D determined that the portion of Lot No. 824 which was unessential to the petitioners' homesite and the corresponding portion of Lot No. 822, aforesaid, were sources of black sand which it needed in its business. HC&D offered to purchase in fee, in the Fall of 1944 and in consideration of $92,000.00, the approximately 4.433 acres of homestead land aforesaid and petitioners accepted said offer. HC&D instructed its attorney to prepare a deed to cover the purchase, but said attorney determined that petitioners had not perfected their title to Lot No. 822 by erecting a residence upon the premises, as required by law. Furthermore, the attorney for HC&D found that the Hawaiian Organic Act and the statutes of the Territory of Hawaii, governing the sale, lease, or other use or disposition of public lands, permitted the said lots to be used for residence purposes only and prohibited any part thereof, or interest therein or control thereof, without the written consent of the commissioner of public lands and the governor of the Territory of Hawaii, being contracted in any way, directly or indirectly, by process of law or otherwise, conveyed, mortgaged, leased, or otherwise transferred to, or acquired or held by or for the benefit of, any alien or corporation. Petitioners, during November, 1944, addressed the Commissioner of Public Lands in office and, after pointing out that war restrictions on private building had prevented

them from constructing upon Lot No. 822 the dwelling required by Special Sale Agreement No. 1763; that the steep, sloping nature of Lot No. 822 required extraordinary grading to prepare it for homesite purposes; that HC&D needed black sand to manufacture tile for the new Tripler General Hospital, a defense project; that the lower portion of Lot 822 was a source of the black sand desired by HC&D; and that HC&D, because of the nature of its business, and not the petitioners, could make the otherwise inaccessible portion of Lot No. 822 immediately useful to the community and helpful to the war effort, requested an extension of time to fulfill the conditions of their Special Sale Agreement of February 24, 1938, and permission to assign to HC&D the lower part of Lot No. 822. Petitioners agreed to post a bond to assure their fulfillment of the condition which required the construction of a dwelling on Lot No. 822. The said Commissioner of Public Lands, on November 30, 1944, granted the petitioners' request for an extension of time to fulfill their obligation to erect a dwelling on the site but disapproved the proposal "made to commercialize the lower portion of this lot in order that the required dwelling house may be constructed."

J. Petitioners and HC&D conceived, subsequently to November, 1944, a plan by means of which HC&D could obtain the black sand which it needed for fulfillment of its Army hospital tile contract and for other commercial purposes and the petitioners could fulfill their obligations under Special Sale Agree-

ment No. 1762, dated February 24, 1938. HC&D employed Roswell Towill, engineer and surveyor, to determine by survey the volume of black sand contained in the lower parts of adjoining Lots Nos. 822 and 824, to plat the area which would remain after removal of the overburden of black sand, in accordance with the requirements of the City Planning Commission, City and County of Honolulu, to construct an access road across the land of an abutting property owner, and to install a water pipeline which would be available to petitioners and to the abutting property owners. The said engineer and surveyor determined by metes and bounds and depth that there were approximately 250,000 cubic yards of black sand beneath a surface area of approximately 192,000 square feet of Lots Nos. 822 and 824 and estimated that the cost, in 1945, of grading the land after removal of the black sand, installing a water pipeline, and completing an access road to Round Top Drive would approximate $32,000.00.

K. Under date of September 4, 1945, to effectuate the plan aforesaid, the petitioners and HC&D executed an Agreement, which recited that the petitioners were the owners of certain interests in Lots 822 and 824 of the Makiki Round Top Lots, City and County of Honolulu; that a portion of the said lots encompassed a surface area of approximately 192,000 square feet, called the "Sand Area," as shown by a survey of R. Towill, and estimated to contain approximately 250,000 cubic yards of black

sand, which HC&D desired to acquire for business purposes; that it was practicable to remove the approximately 250,000 cubic yards of black sand and, with proper grading, leave the premises suitable for home building sites, provided that an access road to Round Top Drive, a government highway, would be constructed over rights of way to be obtained from abutting property owners, and that petitioners were negotiating for the said rights of way; that HC&D was willing to buy petitioners' interest in the land which comprised the said "Sand Area" or to quarry, buy and haul away black sand therefrom, and that petitioners, subject to receiving the consent of the Commissioner of Public Lands, Territory of Hawaii, was willing to sell the said "Sand Area"; that HC&D agreed to obtain at its expense a plan of subdivision of the said "Sand Area" locating and showing thereon an access roadway to the nearest government highway; that HC&D agreed to purchase, with the consent of the said Commissioner of Public Lands, the interest of the petitioners in and to the said "Sand Area" and to pay therefor fifty cents (50c) per square foot of land within the said "Sand Area"; that, if the said Commission would not consent to the sale of the petitioners' interest in the said "Sand Area" but would permit HC&D to quarry and withdraw black sand from said "Sand Area," HC&D agreed to quarry and haul away from the said "Sand Area" approximately 250,000 cubic yards of black sand and to pay therefore at the rate of forty cents (40c) per cubic yard, within five years form the date of the Agree-

ment; that HC&D, after withdrawal of the approximately 250,000 cubic yards of black sand from the said "Sand Area" agreed to complete, within the time limit set, the grading of the sand area subdivision and to leave the area in condition for sale and use as building sites with road and water mains in the manner required by the City Planning Commission and the Board of Water Supply, City and County of Honolulu, and to pave the access road to the nearest government highway across the lands of abutting property owners; that the petitioners agreed to sell their interest in the land comprising the "Sand Area" or in approximately 250,000 cubic yards of black sand, upon the terms and conditions aforesaid, provided that the consent of the said Commissioner of Public Lands was first obtained and that rights of way for an access road were obtained from abutting property owners; that petitioners and HC&D mutually agreed that, with the consent of the Commissioner of Public Lands, their preferences were to sell and buy, respectively, the petitioners' interest in the said "Sand Area" rather than to sell and buy, respectively, black sand; that in the event the petitioners sold their interest in the said "Sand Area" to HC&D, real property taxes would be prorated; and that the agreement should become and remain in force only upon obtaining the appropriate approval and consent of the said Commissioner of Public Lands.

L. Petitioners and HC&D believed and agreed that petitioners should perfect their title to Lot No.

822 before performance of the terms of the Agreement of September 4, 1945. The termination of hostilities of World War II had made available for the erection of private dwellings, construction materials in the possession of HC&D, which, to speed the petitioners' acquisition of title to Lot No. 822 and performance under the Special Sale Agreement of September 4, 1945, agreed to advance the materials and labor for the construction of a dwelling on Lot No. 822. Construction of the dwelling on Lot No. 822 was begun during January, 1946, and was completed several months later, at a cost to the petitioners of $19,322.81. To secure HC&D against loss, the petitioners agreed to execute and deliver to HC&D a non-interest bearing mortgage of the premises.

M. Under date of May 23, 1946, the Governor of the Territory of Hawaii duly executed Land Patent No. 11,315, which granted and confirmed unto the petitioners, as joint tenants with full right of survivorship, title to Lot No. 822, Makiki Round Top Drive, City and County of Honolulu, in consideration of $8,150.00 and compliance with the terms and conditions of Special Sale Agreement No. 1762, issued on February 24, 1938, covering 2.97 acres of land.

N. Because of the delay experienced by the petitioners in perfecting their title to Lot No. 822, aforesaid, HC&D was delayed, until on or about July 1, 1946, in commencing its performance of the

terms of the Agreement of September 4, 1945, aforesaid. Petitioners' banker, Bishop National Bank of Hawaii at Honolulu, inquired of HC&D the status of the said Agreement, and HC&D, under date of August 1, 1947, informed the said banker that the aforesaid Agreement obligated it to remove from Lots 822 and 824 approximately 250,000 cu. yds. of black cinder, to pay therefor at the rate of 40c per cubic yard for all cinder removed, to subdivide and terrace the remainder of the approximately 4.433 acres into eighteen house lots of approximately 11,000 sq. ft. each, to install water mains, and to construct a paved access road to the area. The petitioners, on August 21, 1947, gave their joint and several note and mortgage for $70,000.00 to Bishop National Bank of Hawaii at Honolulu, and, as additional security therefor, petitioners assigned to Bishop National Bank of Hawaii at Honolulu, under date of September 9, 1947, all of their right, title and interest in and to all moneys, rights, claims, privileges, covenants and agreements made for their benefit and provided for or contained in the Agreement of September 4, 1945, aforesaid.

O. HC&D, when asked to accept the assignment aforesaid, addressed the petitioners, on September 16, 1947, and pointed out that it was incumbent upon HC&D to complete the removal of approximately 250,000 cu. yds. of cinder (black sand) and the installation of the prescribed improvements on Lots No. 822 and 824, aforesaid, within five years from September 1, 1945, that HC&D had been unable to

commence removal of cinder from the said area until petitioners had perfected their title to Lot No. 822, which had occurred on or about July 1, 1946, that HC&D had entered into a parallel, five-year agreement, effective July 1, 1946, with adjoining property owners over whose lands the access road to the aforesaid black sand area was to be constructed, and requested petitioners to grant an extension of time to July 1, 1951 (five years from July 1, 1946), within which to remove the approximately 250,000 cu. yds. of black sand and to complete the improvements required by the agreement of September 4, 1945, aforesaid. Petitioners, under date of October 8, 1947, assured HC&D that, upon the payment in full of the petitioners' joint and several note for $70,000.00, aforesaid, by the application thereto of the proceeds from the sale of the black sand, they would extend to July 1, 1951, the period for the removal of the black sand and the completion of the improvements required by the aforesaid agreement.

P. Early during 1950, HC&D realized that, for certain reasons, it would be unable to remove, on or before July 1, 1951, the balance of the approximately 250,000 cu. yds. of black sand from the 4.433-acre portion of Lots No. 822 and 824, aforesaid, and to complete the grading thereof, all as required by the agreement of September 4, 1945, as amended, and requested an extension of time to July 1, 1952, within which to complete its performance of the terms of the said agreement. Under date of May 19,

1950, HC&D and petitioners executed an agreement extending to July 1, 1952, the period for completion of its "right and obligation" to remove the balance —estimated then to be approximately 133,000 cu. yds.—of the approximately 250,000 cu. yds. of black sand from Lots 822 and 824, aforesaid, and to complete the improvement of the said lots in the manner specified. As consideration for extending the said period to July 1, 1952, HC&D agreed to endorse a joint and several promissory note of the petitioners for $48,960.00, payable to the Bishop National Bank of Hawaii at Honolulu, in liquidation of the balance due on their note for $70,000.00, payable to the said Bank and dated August 21, 1947; to pay the balance due on the purchase price of the approximately 250,000 cu. yds. of black sand at the rate of $2,040.00 monthly; to pay the interest which accrued after May 19, 1950, on the said $48,960.00 note; to pay the real property taxes attributable to the 4.433-acre area; and to perform the petitioners' obligations to the adjacent property owners who had granted to petitioners rights-of-way for an access road across their lands. The assignment of September 9, 1947, aforesaid, was cancelled, and the petitioners assigned to the Bank aforesaid, until the said note was paid in full, the payments due on the black sand contract.

Q. Pursuant to the agreement of May 19, 1950, aforesaid, HC&D paid to Bishop National Bank of Hawaii at Honolulu, during the calendar year 1950, $753.78 interest on petitioners' note for $48,960.00, dated May 19, 1950. The Commissioner of Internal

Revenue included in his determination of the proceeds which petitioners received during 1950, viz., $19,126.57, on account of the sales price of the black sand en bloc, aforesaid, $741.13 of the $753.78 interest which HC&D paid during 1950 for the petitioners' account. The $741.13 was an understatement, made by the Commissioner, of the amount of said interest.

R. HC&D completed its performance of the terms of the agreement of September 4, 1945, as amended, during 1952. Formal acceptance by the petitioners, of the removal of 250,010 cubic yards of black sand from the "Sand Area," of the grading of the 4.433-acre area included in Lots No. 822 and 824, of the installation of water mains, and of the construction of an access road by HC&D, occurred on September 15, 1952. The formal acceptance by the City and County of Honolulu, of the access road, occurred on October 2, 1952, and the formal acceptance by the Board of Water Supply, City and County of Honolulu, of the water mains installation occurred on November 5, 1952.

S. The actual cost to HC&D of the improvement of the 4.433-acre area of Lots 822 and 824, aforesaid, in the manner that was required by the agreement of September 4, 1945, as amended, was $69,254.23. When the improvements required by the Agreement of September 4, 1945, were contemplated, during 1945, it was estimated that their cost would approximate $32,000.00.

T. The fair market value on September 4, 1945, of the contract which was executed by the petitioners and HC&D on the said date, as aforesaid, was not less than $113,135.65.

U. During the calendar year 1945, the petitioners did not receive from HC&D, neither directly nor indirectly, any payment in cash or its equivalent other than the contract of September 4, 1945, on account of the consideration due to the petitioners under the terms of the said Agreement of September 4, 1945, by and between the petitioners and HC&D. The first payment on account of the sales price of the black sand en bloc was made by HC&D and was received by the petitioners during the calendar year 1947.

V. HC&D withdrew black sand from the "Sand Area" which it had purchased en bloc from the petitioners on September 4, 1945, and paid therefore in cash to the petitioners or, at their direction, to their banker, in the manner provided in the Agreement of September 4, 1945, as amended, by years as follows:

Years	Cubic Yards	Cash Payments
1947	35,897.47	$ 14,358.98*
1948	30,694.50	15,463.83*
1949	40,356.25	12,600.00
1950	44,692.25	19,126.57
1951	16,414.50	24,480.00
1952	81,955.03	13,974.62
Totals	250,010.00	$100,004.00

*As received by petitioners: $13,247.18 (1947); $16,575.63 (1948)

W. HC&D reimbursed petitioners for real property taxes paid by petitioners on the "Sand Area" which HC&D had purchased en bloc, as follows:

Years	Amounts
1950	$276.35
1951	525.96
1952	283.45

X. By virtue of the Agreement dated September 4, 1945, by and between petitioners and HC&D, the petitioners divested themselves, and HC&D acquired, all of the petitioners' right, title, and interest in and to the said "Sand Area," which comprised approximately 192,000 square feet of surface area and approximately 250,000 cubic yards of black sand.

Y. The petitioners, excepting the black sand sold en bloc pursuant to the Agreement of September 4, 1945, as amended, have never sold any black sand or cinders as such, neither by the load nor in any other quantity, to any person, natural or artificial. The petitioners had never advertised nor held for sale any commodity, nor had they maintained, at any time, an office or employed brokers to sell real estate, black sand, or any other commodity.

Z. In their joint income tax return for the calendar year 1948, the petitioners included in their gross income, on account of the sales price of black sand sold en bloc to HC&D pursuant to the Agreement of September 4, 1945, a long-term capital gain of $7,326.80, which purported to be 50 per centum of $15,463.83, which HC&D determined was due to the petitioner on account of the sale of the black sand

en bloc and which was payable upon the basis of black sand removed monthly during 1948.

AA. The Commissioner of Internal Revenue determined that the moneys which HC&D paid to petitioners during 1948 pursuant to the Agreement of September 4, 1945, were ordinary income and substituted for the $7,326.80 which petitioners had returned as aforesaid, $16,575.63, which comprises the $15,463.83 that was based upon withdrawals of black sand from the "Sand Area" during 1948 and $1,111.80 that HC&D paid to petitioners during January, 1948, upon the basis of black sand removed during December, 1947.

BB. In their joint income tax return for the calendar year 1949, the petitioners included in their gross income, on account of the sales price of black sand sold en bloc to HC&D pursuant to the Agreement of September 4, 1945, a long-term capital gain of $6,300.00, which is 50 per centum of the $12,600.00 that HC&D determined was due to the petitioners on account of the sales price of the black sand sold en bloc and payable upon the basis of black sand removed monthly during 1949.

CC. The Commissioner of Internal Revenue determined that the moneys which HC&D paid to petitioners during 1949 pursuant to the Agreement of September 4, 1945, were ordinary income and substituted for the $6,300.00 which petitioners had returned as aforesaid, $12,600.00 which the petitioners had actually received from HC&D during the calen-

dar year 1949 upon the basis of black sand removed during 1949.

DD. In their joint income tax return for the calendar year 1950, the petitioners included in their gross income on account of the sales price of black sand sold en bloc to HC&D pursuant to the Agreement of September 4, 1945, a long-term capital gain of $8,543.29, which purported to be 50 per centum of the $19,126.57 that HC&D determined was due to the petitioners on account of the sales price of the black sand sold en bloc and payable, until May 19, 1950, upon the basis of black sand removed monthly during 1950. Commencing June 20, 1950, the balance due on the sales price of the black sand sold en bloc to HC&D became payable at the rate of $2,040.00 monthly. Petitioners inadvertently omitted from their determination of the long-term capital gain which they included in their gross income for 1950, one monthly payment of $2,040.00 which they received during 1950.

EE. The Commissioner of Internal Revenue determined that the moneys which HC&D paid to petitioners during 1950 pursuant to the Agreements of September 4, 1945, as amended, and May 19, 1950, were ordinary income and substituted for the $8,543.29 which petitioners had returned as aforesaid, $19.867.70, which comprises $19,126.57 that the petitioners actually received during 1950 on account of the sales price of the black sand sold en bloc to HC&D and payable upon the basis of the Agreements of September 4, 1945, and May 19, 1950, both

aforesaid, and $741.13 of the $753.78 interest which the petitioners actually received during 1950 pursuant to the Agreement of May 19,1950.

FF. The petitioners and HC&D intended that the transaction the subject of the Agreement of September 4, 1945, as amended, should be a sale of black sand en bloc. The benefits and burdens of ownership of the "Sand Area" passed absolutely from the petitioners to HC&D on September 4, 1945, in accordance with the intentions of the parties and in fact.

GG. The costs of Lots 822 and 824, aforesaid, and the allocation of the said costs to the portion of the lots: 1) retained by the petitioners for homesite purposes; 2) sold during 1947, and, 3) subject to the provisions of the Agreement of September 4, 1945, follow:

Costs:

Lot No. 822	$ 7,500.00
Lot No. 824	8,150.00
Total	$15,650.00

Allocation:

Usage	Area Sq. Ft.	Cost Allocation
Homesites	56,936	$ 3,426.17
Lot sold	10,018	602.84
"Sand Area"	193,117	11,620.99
Totals	260,071	$15,650.00

HH. Petitioners duly filed with the Collector of Internal Revenue, District of Hawaii, claims for the refund of income taxes overassessed and overpaid for the calendar years 1948, 1949, and 1950, in the

amounts respectively of $1,656.92, $1,657.22, and $2,827.70, on the ground that they had erred in including in their gross incomes for the calendar years aforesaid long-term capital gains which they had realized in fact during a calendar and taxable year prior to 1948, namely, during the calendar year 1945.

II. The petitioners had not claimed, and the Commissioner of Internal Revenue has not allowed, in the determination of the petitioners' taxable net incomes for the calendar years 1948, 1949, and 1950, any depletion of natural deposits, as provided in sections 23(m) and 114(b)(4), I.R.C.

Wherefore, the petitioners pray that this Court may hear the proceeding and determine a) that the Agreement of September 4, 1945, effected a completed sale, in 1945, of black sand in place; b) that the black sand in place was a capital asset, as defined in section 117(a)(1), I.R.C.; c) that the capital asset had been held by the petitioners in excess of six months; d) that the only consideration received by the petitioners during 1945 as consideration for the said sale was the contract dated September 4, 1945, aforesaid, and that the fair market on September 4, 1945, of the said contract was $113,135.65; e) that the amounts received by the petitioners from HC&D, i.e., $16,575.63 during 1948, $12,600.00 during 1949, and $19,126.57 during 1950, on account of the sales price of the black sand in place were not incomes of the petitioners received during the calendar years 1948, 1949, and 1950; f) that there are no deficiencies in the petitioners' returns of income

taxes for the calendar years 1948, 1949, and 1950 and that, instead, the petitioners are entitled to refunds of income taxes overpaid for the said taxable years as claimed aforesaid; g) that alternatively, if the Court were to determine that the aforesaid agreement effected the sale of a capital asset on the installment plan, the amounts which the petitioners received from HC&D during the calendar years 1948, 1949, and 1950 were long-term capital gains and taxable as such; and, h) that alternatively, if the Court were to find that the petitioners were dealers in black sand, the petitioners be allowed statutory depletion of natural deposits, in the determination of their taxable incomes for the calendar years 1948, 1949, and 1950.

/s/ E. R. CAMERON,

/s/ H. C. DUNN,

/s/ DORIS E. BENNETT,

Counsel for Petitioners.

Duly verified.

EXHIBIT A

U. S. Treasury Department
Office of the District Commissioner
Internal Revenue Service

Appellate Division—Los Angeles District
Room 710—630 Sansome Street

San Francisco 11, California

June 5, 1953.

In Replying Refer To:
ADC-Ap:LA
SF: LVH:DRU-150-D
Mr. Louis L. Gowans and
Mrs. Helen T. Gowans
(Husband and Wife)
2785 Round Top Drive
Honolulu, Hawaii

Dear Mr. and Mrs. Gowans:

You are advised that the determination of your income tax liability for the taxable years ended December 31, 1948, December 31, 1949, and December 31, 1950, discloses a deficiency of $9,561.30 as shown in the statement attached.

In accordance with the provisions of existing internal revenue laws, notice is hereby given of the deficiency mentioned.

Within 150 days from the date of the mailing of this letter you may file a petition with The Tax Court of the United States, at its principal address,

Washington 4, D. C., for a redetermination of the deficiency. In counting the 150 days you may not exclude any day unless the 150th day is a Saturday, Sunday, or legal holiday in the District of Columbia, in which event that day is not counted as the 150th day. Otherwise Saturdays, Sundays and legal holidays are to be counted in computing the 150-day period.

Should you not desire to file a petition, you are requested to execute the enclosed form and forward it to the Assistant District Commissioner, Appellate, Room 710, 630 Sansome Street, San Francisco 11, California. The signing and filing of this form will expedite the closing of your return by permitting an early assessment of the deficiency, and will prevent the accumulation of interest, since the interest period terminates 30 days after receipt of the form, or on the date of assessment, or on the date of payment, whichever is earlier.

Very truly yours,

T. COLEMAN ANDREWS,
Commissioner;

By /s/ WM. G. WILKER,
Assistant Head
Appellate Division.

Enclosures:
Statement
Form 1276
Agreement Form

Statement

ADC-Ap:LA
SF:LVH:DRU-150-Day

Mr. Louis L. Gowans and
Mrs. Helen T. Gowans,
Husband and Wife
2785 Round Top Drive
Honolulu, Hawaii

Tax Liability for the Taxable Years Ended December 31, 1948, December 31, 1949 and December 31, 1950.

	Year	Deficiency
Income Tax	1948	$ 2,784.52
Income Tax	1949	2,016.86
Income Tax	1950	4,759.92
Total		$ 9,561.30

In making this determination of your income tax liability, careful consideration has been given to your protests dated September 12, 1951, and December 18, 1951; to the statements made at the conferences held on November 25, 1952, and on prior dates; and to your claims for refund filed on February 4, 1952.

If a petition to The Tax Court of the United States is filed against the deficiency proposed herein, the issue set forth in your claims for refund should be made a part of the petition to be considered by The Tax Court in any redetermination of your tax liability. If a petition is not filed, the claims for refund will be disallowed and official notice will be issued by registered mail in accordance with section 3772 of the Internal Revenue Code.

A copy of this letter and statement has been mailed to your representative, Mr. E. R. Cameron, c/o Cameron, Tennent & Greaney, P. O. Box 3556, Honolulu 11, Hawaii, in accordance with the authority contained in the power of attorney executed by you.

Adjustments to Net Income
Year: 1948

Net income as disclosed by return		$14,672.93
Unallowable deductions and additional income:		
(a) Ordinary income from sale of sand	$16,575.63	
(b) Taxes	31.20	16,606.83
Total		$31,279.76
Nontaxable income and additional deductions:		
(c) Net capital gain		$ 7,326.80
Net income as adjusted		$23,952.96

Explanation of Adjustments

(a) In your income tax returns for calendar years 1948, 1949, and 1950, you have reported as income from the sale of sand the following amounts:

Year	Amount
1948	$14,653.60
1949	12,600.00
1950	17,086.57

In determining the tax liability on these returns you have treated such income as long-term capital gains and only included 50% of such income in adjusted gross income. In claims for refund, filed February 4, 1952, you have contended that such income was income in the year 1945, the year in which the contract providing for above payments was made, and that you were in error in reporting any part of such income on returns for years 1948, 1949, and 1950.

It is held that the correct amount of payments received under the above-mentioned contract was as follows:

Year	Amount
1948	$16,575.63
1949	12,600.00
1950	19,867.70

It is further held that such payments did not represent capital gains within the meaning of section 117 of the Internal Revenue Code and that 100% of such payments were includible in the adjusted gross incomes of the years in which the payments were received.

(b) Deductions under taxes of $30.00 for Federal tax on country club dues and $1.20 for dog license are disallowed because such items are not deductible under the Internal Revenue Code.

(c) Capital gain of $7,326.80 (50% of $14,653.60) reported on your return from the sale of sand is eliminated for the reason set forth in item (a) above.

Computation of Income Tax
Year: 1948

Net income	$23,952.96	
Less 2 exemptions at $600 each	1,200.00	
Normal tax and surtax net income	$22,752.96	
One-half of normal tax and surtax net income	$11,376.48	
Tentative tax		$ 3,163.06
Less: 17. % on $ 400.00	$ 68.00	
12. % on $2,763.06	331.57	399.57
Balance		$ 2,763.49
Total income tax—twice the above balance		$ 5,526.98
Income tax liability		5,526.98
Income tax liability disclosed by original return Account No. 908505, District Hawaii		2,742.46
Deficiency in income tax		$ 2,784.52

Adjustments to Net Income
Year: 1949

Net income as disclosed by return		$18,362.46
Unallowable deductions and additional income:		
(a) Ordinary income from sale of sand	$12,600.00	
(b) Taxes	30.00	12,630.00
Total		$30,992.46
Nontaxable income and additional deductions:		
(c) Net capital gain		6,300.00
Net income as adjusted		$24,692.46

Explanation of Adjustments

(a) and (c) Ordinary income of $12,600.00 from the sale of sand is included in adjusted gross income and net capital gain of $6,300.00 reported on the sale of sand is eliminated from income as explained in item (a) for the taxable year 1948.

(b) Deduction of $30.00 for Federal tax on country club dues is disallowed because such item is not deductible under the Internal Revenue Code.

Computation of Income Tax
Year: 1949

Net income	$24,692.46	
Less 2 exemptions at $600.00 each	1,200.00	
Normal tax and surtax net income	$23,492.46	
One-half of normal tax and surtax net income	$11,746.23	
Tentative tax		$ 3,303.57
Less: 17. % on $ 400.00	$ 68.00	
12. % on $2,903.57	348.43	416.43
Balance		$ 2,887.14
Total income tax—twice the above balance		$ 5,774.28
Income tax liability		5,774.28
Income tax liability disclosed by original return Account No. 3193258, District Hawaii		3,757.42
Deficiency in income tax		$ 2,016.86

Adjustments to Net Income
Year: 1950

Net income as disclosed by return		$25,464.35
Unallowable deductions and additional income:		
(a) Ordinary income from sale of sand		19,867.70
Total		$45,332.05
Nontaxable income and additional deductions:		
(b) Net capital gain	$ 8,543.29	
(c) Mathematical error	100.00	8,643.29
Net income as adjusted		$36,688.76

Explanation of adjustments

(a) and(b) Ordinary income of $19,867.70 from the sale of sand is included in adjusted gross income and net capital gain of $8,543.29 reported on the sale of sand is eliminated from income as explained in item (a) for the taxable year 1948.

(c) Dividends, interest and other income were reported on line 3 of your return as $12,037.54 instead of $11,937.54 as itemized on page 2 of the return. Accordingly, taxable income is decreased by the difference of $100.00.

Computation of Income Tax
Year: 1950

Net income		$36,688.76
Less: 2 exemptions at $600.00		1,200.00
Income subject to tentative tax		$35,488.76
Income subject to tentative tax if separate return; or one-half of such income if joint return		$17,744.38
Tentative tax		$ 6,072.19
Tax Reduction: $ 400.00 at 13%	$ 52.00	
$5,672.19 at 9%	510.50	562.50
Combined normal tax and surtax		$ 5,509.69
Multiply amount of combined tax by 2 if joint return		$11,019.38
Balance of income tax liability		11,019.38
Income tax liability disclosed by return Account No. 9105106, District Hawaii		6,259.46
Deficiency in income tax		$ 4,759.92

Received and Filed September 4, 1953, T.C.U.S.

Served September 8, 1953.

[Title of Tax Court and Cause.]

ANSWER

Comes now the Commissioner of Internal Revenue, respondent above named, by his attorney, Kenneth W. Gemmill, Acting Chief Counsel, Internal Revenue Service, and for answer to the petition filed by the above-named petitioner admits, denies and alleges as follows:

I and II. Admits the allegations contained in paragraphs I and II of the petition.

III. Admits the deficiencies as determined by the Commissioner of Internal Revenue are in income taxes for the calendar years 1948, 1949, and 1950, in the aggregate amount of Nine Thousand Five Hundred Sixty-one Dollars and Thirty Cents ($9,561.30), by years as follows: 1948, $2,784.52; 1949, $2,016.86; and 1950, $4,759.92, and petitioners claim refunds of income taxes for the calendar years 1948, 1949, and 1950, as follows: 1948, $1,656.92; 1949, $1,657.22; and 1950, $2,827.70, a total of $6,141.84, making a grand total at issue of $15,703.14.

IV. A-F, inclusive. Denies that the Commissioner erred in the determination of the deficiencies as alleged in paragraph IV of the petition and subparagraphs A to F, inclusive, thereunder.

V. A and B. Admits the allegations contained in paragraph V of the petition and subparagraphs A and B thereunder.

C. For lack of knowledge or information sufficient to form a belief, denies the allegations contained in subparagraph C of paragraph V of the petition.

D. Admits during the period begun June 1, 1945, and ended June 30, 1949, there was in effect in the Territory of Hawaii a Community Property Law. The said law provided that all property, both real and personal, including the earnings of the husband and the earnings of the wife and including rents, issues, income and other profits of the separate property of the husband and the wife, acquired by the husband or by the wife after marriage or on or after the effective date of the said Act, whichever was the later, should be community property of the husband and wife, and each was vested with an undivided one-half interest therein; denies the remaining allegation contained in subparagraph D of paragraph V of the petition.

E. For lack of knowledge or information sufficient to form a belief, denies the allegations contained in subparagraph E of paragraph V of the petition.

F. Denies the allegations contained in subparagraph F of paragraph V of the petition.

G. and H. For lack of knowledge or information sufficient to form a belief, denies the allegations contained in subparagraphs G and H of paragraph V of the petition.

I. Admits the Honolulu Construction & Draying Company, Limited, a Hawaiian corporation engaged in business as a general construction contractor and manufacturer of tile, in the City and County of Honolulu, hereinafter referred to as "HC&D," had need for black sand for the manufacture of tile products and for other purposes; admits HC&D determined that a portion of Lot No. 824 and a portion of Lot No. 822, were sources of black sand which it needed in business; admits HC&D offered to purchase in 1944, approximately 4.433 acres of homestead land aforesaid and that HC&D instructed its attorney to prepare a deed to cover the purchase, but said attorney determined that petitioners had not perfected their title to Lot. No. 822 by erecting a residence upon the premises, as required by law; admits furthermore, the attorney for HC&D found that the Hawaiian Organic Act and the statutes of the Territory of Hawaii, governing the sale, lease, or other use or disposition of public lands, permitted the said lots to be used for residence purposes only and prohibited any part thereof, or interest therein or control thereof, without the written consent of the commissioner of public lands and the governor of the Territory of Hawaii, being contracted in any way, directly or indirectly, by process of law or otherwise, conveyed, mortgaged, leased, or otherwise transferred to, or acquired or held by or for the benefit of, any alien or corporation. Denies the remaining allegations contained in subparagraph I of paragraph V of the petition.

J-P, inclusive. For lack of knowledge or information sufficient to form a belief, denies the allegations contained in subparagraphs J to P, inclusive, of paragraph V of the petition.

Q. Admits pursuant to the agreement of May 19, 1950, aforesaid, HC&D paid to Bishop National Bank of Hawaii at Honolulu, during the calendar year 1950, $753.78 interest on petitioners' note for $48,960.00, dated May 19, 1950; the Commissioner of Internal Revenue included in his determination of the proceeds which petitioners received during 1950, viz., $19,126.57, on account of the item of black sand and $741.13 of the $753.78 interest which HC&D paid during 1950 for the petitioners' account; and the $741.13 was an understatement, made by the Commissioner, of the amount of said interest. Denies the remaining allegations contained in subparagraph Q of paragraph V of the petition.

R and S. For lack of knowledge or information suffcient to form a belief, denies the allegations contained in subparagraphs R and S of paragraph V of the petition.

T and U. Denies the allegations contained in subparagraphs T and U of paragraph V of the petition.

V. Admits HC&D withdrew black sand from the "Sand Area" and paid therefor in cash to the petitioners or, at their direction, to their banker, in the manner provided in the Agreement of September 4, 1945, as amended, by years as follows:

Years	Cubic Yards	Cash Payments
1948	30,694.50	$16,575.63
1949	40,356.25	12,600.00

Denies the remaining allegation contained in subparagraph V of paragraph V of the petition and specifically denies that for the year 1950, the cash payment received by petitioners was $19,126.57.

W. For lack of knowledge or information sufficient to form a belief, denies the allegations contained in subparagraph W of paragraph V of the petition.

X and Y. Denies the allegations contained in subparagraphs X and Y of paragraph V of the petition.

Z. Admits that in their joint income tax return for the calendar year 1948, the petitioners included in their gross income, on account of the black sand, a long-term capital gain of $7,326.80, which purported to be 50 per centum of $14,653.60, which HC&D determined was due to the petitioners on account of the black sand and which was payable upon the basis of black sand removed monthly during 1948; denies the remaining allegations contained in subparagraph Z of paragraph V of the petition.

AA. Admits the Commissioner of Internal Revenue determined that the moneys which HC&D paid to petitioners during 1948 pursuant to the Agreement of September 4, 1945, were ordinary income and substituted for the $7,326.80 which petitioners had returned as aforesaid, $16,575.63; denies the

remaining allegations contained in subparagraph AA of paragraph V of the petition.

BB. Admits that in their joint income tax return for the calendar year 1949, the petitioners included in their gross income, on account of the disposition of black sand to HC&D pursuant to the Agreement of September 4, 1945, a long-term capital gain of $6,300.00, which is 50 per centum of the $12,600.00 that HC&D determined was due to the petitioners on account of the black sand and payable upon the basis of black sand removed monthly during 1949; denies the remaining allegations contained in subparagraph BB of paragraph V of the petition.

CC. Admits the allegations contained in subparagraph CC of paragraph V of the petition.

DD. Admits that in their joint income tax return for the calendar year 1950, the petitioners included in their gross income on account of the disposition of black sand to HC&D pursuant to the Agreement of September 4, 1945, long-term capital gain of $8,543.29, which purported to be 50 per centum of the $17,086.57 that HC&D determined was due to petitioners on account of the black sand and payable, upon the basis of black sand removed monthly during 1950; petitioners omitted from their determination of the long-term capital gain which they included in their gross income for 1950, one monthly payment of $2,040.00 which they received during 1950. Denies the remaining allegations contained in subparagraph DD of paragraph V of the petition.

EE. Admits the Commissioner of Internal Revenue determined that the moneys which HC&D paid to petitioners during 1950 pursuant to the Agreements of September 4, 1945, as amended, and May 19, 1950, were ordinary income and substituted for the $8,543.29 which petitioners had returned as aforesaid, $19,867.70, which comprises $19,126.57 that the petitioners actually received during 1950 on account of the black sand granted to HC&D and payable upon the bases of the Agreements of September 4, 1945, and May 19, 1950, both aforesaid, and $741.13 of the $753.78 interest which the petitioners actually received during 1950 pursuant to the Agreement of May 19, 1950; denies the remaining allegations contained in subparagraph EE of paragraph V of the petition.

FF. Denies the allegations contained in subparagraph FF of paragraph V of the petition.

GG. For lack of knowledge or information sufficient to form a belief, denies the allegations contained in subparagraph GG of paragraph V of the petition.

HH. Admits the allegations contained in subparagraph HH of paragraph V of the petition.

II. Admits the allegations contained in subparagraph II of paragraph V of the petition.

VI. Denies generally and specifically each and every allegation in the petition not hereinbefore admitted, qualified or denied.

Wherefore, it is prayed that the Commissioner's determination be approved and the petitioners' appeal denied.

/s/ KENNETH W. GEMMILL,
Acting Chief Counsel,
Internal Revenue Service.

Filed October 26, 1953, T.C.U.S.

[Title of Tax Court and Cause.]

STIPULATION

The petitioners and the respondent by their respective attorneys hereby stipulate to the following facts:

A. The petitioners are husband and wife, citizens of the United States, and residents of the City and County of Honolulu, Territory of Hawaii.

B. Petitioners always have computed their net incomes upon the bases of cash receipts and disbursements and calendar year.

C. Throughout the period begun January 1, 1945, and ended December 31, 1950, as well as prior and subsequent to said period, each of the petitioners has been employed full time by the Honolulu Gas Company, Limited, a public utility, in Honolulu, Hawaii.

D. The petitioners, throughout their lives as husband and wife, have combined their services,

earnings, and capital. Their investments have been joint.

E. Under date of December 28, 1932, the petitioners, as point tenants, purchased from A. V. Gear, under an agreement of sale, a parcel of land, in consideration of $7,500.00, lot 824, Makiki Round Top Lots, City and Couty of Honolulu, containing an area of three (3) acres, more or less. A. V. Gear had acquired the said lot under the Homestead Laws of the Territory of Hawaii, Land Patent Grant Number 6815, a copy of which is hereto attached as Exhibit I, under date of February 20, 1917. Gear died testate before the purchase price had been paid in full, and devised Lot 824, subject to the Agreement of Sale, to his wife. The widow, Addie B. Gear, died testate under similar circumstances and devised Lot 824, subject to the Agreement of Sale, to her children. The Gears' children, Harold B. Gear and Hazel Gear Raseman, after receipt of payment in full of account of the sale price of said homesite, deeded to the petitioners, on July 5, 1936, Lot 824 aforesaid. A copy of said deed is hereto attached as Exhibit I-A.

F. Petitoners sold 10,018 square feet of Lot 824 aforesaid, facing Round Top Drive, by unrecorded agreement of sale dated April 30, 1946. Upon payment, during 1947, of the final installment of the consideration of $10,000.00, petitioners executed on October 8, 1947, and delivered to the purchasers, a deed.

G. During September, 1937, the petitioners be-

gan the construction upon Lot 824, Makiki Round Top Lots, at 2785 Round Top Drive, of their home, which they have occupied continuously since its erection. An extension thereto was begun in November, 1944.

H. On February 24, 1938, the petitioners purchased at public auction, under Special Sale Agreement No. 1762, a copy of which is hereto attached as Exhibit II, in consideration of $8,150.00, in accordance with the provisions of section 73 of the Hawaiian Organic Act and Chapter 54, Revised Laws of Hawaii, 1935, Lot No. 822, Makiki Round Top Lots, City and County of Honolulu, containing two and ninety-seven hundredths (2.97) acres of land. Lot 822 adjoins Lot No. 824, both aforesaid.

I. Honolulu Construction & Draying Company, Limited, a Hawaiian corporation engaged in business as a general construction contractor and manufacturer of tile in the City and County of Honolulu, hereinafter referred to as "HC&D," had need for black sand for the manufacture of tile products and for other purposes. HC&D determined that the portion of Lot No. 824 which was unessential to the petitioners' homesite and the corresponding portion of Lot No. 822 aforesaid, were sources of black sand which it needed in its business. HC&D offered to purchase in fee, in the Fall of 1944, the approximately 4.433 acres of homestead land aforesaid and petitioners were agreeable to the said offer. HC&D instructed its attorney to prepare a deed to cover the purchase, but said attorney determined

that petitioners had not perfected their title to Lot No. 822 by erecting a residence upon the premises, as required by law. Furthermore, the attorney for HC&D found that the Hawaiian Organic Act and the statutes of the Territory of Hawaii governing the sale, lease, or other use or disposition of public lands, permitted the said lots to be used for residence purposes only and prohibited any part thereof, or interest therein or control thereof, without the written consent of the Commissioner of Public Lands and the Governor of the Territory of Hawaii, being contracted in any way, directly or indirectly, by process of law or otherwise, conveyed, mortgaged, leased, or otherwise transferred to, or acquired or held by or for the benefit of, any alien or corporation. Attached hereto as Exhibit III is a copy of a letter addressed to the Commissioner of Public Lands by Petitioner. Attached hereto as Exhibit IV is a copy of the Commissioner's reply thereto.

J. Petitioners and HC&D conceived, subsequently to November, 1944, a plan by means of which HC&D could obtain the black sand which it needed for other commercial purposes and the petitioners could fulfill their obligations under Special Sale Agreement No. 1762, dated February 24, 1938. HC&D employed Rosewell Towill, engineer and surveyor, to determine by survey the volume of black sand contained in the lower parts of adjoining Lots Nos. 822 and 824, to plat the area which would remain after removal of the overburden of black sand,

in accordance with the requirements of the City Planning Commission, City and County of Honolulu, to construct an access road across the land of an abutting property owner, and to install a water pipeline which would be available to petitioners and to the abutting property owners. The said engineer and surveyor determined by metes and bounds and depth that there were approximately 250,000 cubic yards of black sand beneath a surface area of approximately 192,000 square feet of Lots Nos. 822 and 824 and estimated that the cost, in 1945, of grading the land after removal of the black sand, installing a water pipeline, and completing an access road to Round Top Drive would approximate $32,000.00.

K. Under date of September 4, 1945, to effectuate the plan aforesaid, the petitioners and HC&D executed an Agreement, a copy of which is attached hereto as Exhibit V.

L. HC&D agreed to advance the materials and labor for the construction of a dwelling on Lot No. 822 in order for petitioners to perfect their title upon termination of hostilities in World War II. Construction of the dwelling on Lot No. 822 was begun during January, 1946, and was completed several months later, at a cost to the petitioners of $19,322.81. To secure HC&D against loss, the petitioners agreed to execute and deliver to HC&D a non-interest-bearing mortgage of the premises notwithstanding the proscription referred to in paragraph I above.

M. Under date of May 23, 1946, the Governor of of the Territory of Hawaii duly executed Land Patent No. 11,315, a copy of which is hereto attached as Exhibit VI.

N. Because of the delay experienced by the petitioners in perfecting their title to Lot No. 822 aforesaid, HC&D was delayed, until on or about July 1, 1946, in commencing its performance of the terms of the Agreement of September 4, 1945, aforesaid. Attached hereto are Exhibits VII, VIII, IX, X and XI relating to financial arrangements made in connection with the removal of the black sand.

O. Attached hereto is Exhibit XII, an agreement of May 19, 1950, modifying Exhibit V.

P. Pursuant to the agreement of May 19, 1950, aforesaid, HC&D paid to Bishop National Bank of Hawaii at Honolulu, during the calendar year 1950, $753.78 interst on petitioners' note for $48,960.00, dated May 19, 1950. The Commissioner of Internal Revenue included in his determination of the proceeds which petitioners received during 1950, viz., $19,126.57, as proceeds from said contract, $741.13 of the $753.78 interst which HC&D paid during 1950 for the petitioners' account. The $741.13 was an understatement, made by the Commissioner, of the amount of said interest.

Q. HC&D withdrew black sand from the "Sand Area" under Exhibits V and XII, and paid therefor in cash to the petitoners or, at their direction, to

their banker, in the manner provided in said exhibits by years as follows:

Years	Cubic Yards	Cash Payments
1947	35,897.47	$ 14,358.98*
1948	30,694.50	15,463.83*
1949	40,356.25	12,600.00
1950	44,692.25	19,126.57
1951	16,414.50	24,480.00
1952	81,955.03	13,974.62
Totals	250,010.00	$100,004.00

*As received by petitioners: $13,247.18 (1947); $16,575.63 (1948)

R. HC&D completed its performance of the terms of the agreement of September 4, 1945, as amended, during 1952.

S. During the calendar year 1945, the petitioners did not receive from HC&D, neither directly nor indirectly, any payment in cash or its equivalent under the contract of September 4, 1945. The first payment under the agreement of September 4, 1945, was made by HC&D and was received by the petitioners during the calendar year 1947.

T. HC&D reimbursed petitioners for real property taxes paid by petitoners on the "Sand Area" as follows:

Year	Amount
1950	$276.35
1951	525.96
1952	283.45

U. In their joint income tax return for the calendar year 1948, the petitioners reported, as a sales price of black sand under the Agreement of September 4, 1945, a long-term capital gain of $7,326.80, which purported to be 50 per centum of $15,463.83, which HC&D determined was due to the petitioners under the contract and which was payable upon the basis of black sand removed monthly during 1948.

V. The Commissioner of Internal Revenue determined that the moneys which HC&D paid to petitioners during 1948 pursuant to the Agreement of September 4, 1945, were ordinary income and substituted for the $7,326.80 which petitioners had returned as aforesaid, $16,575.63, which comprises the $15,463.84 that was based upon withdrawals of black sand from the "Sand Area" during 1948 and $1,111.80 that HC&D paid to petitioners during January, 1948, upon the basis of black sand removed during December, 1947.

W. In their joint income tax return for the calendar year 1949, the petitioners reported as the sales price of black sand under the Agreement of September 4, 1945, a long-term capital gain of $6,300.00, which is 50 per centum of the $12,600.00 that HC&D determined was due to the petitioners under the contract and payable upon the basis of black sand removed monthly during 1949.

X. The Commissioner of Internal Revenue determined that the moneys which HC&D paid to petitioners during 1949 pursuant to the Agreement of September 4, 1945, were ordinary income and sub-

stituted for the $6,300.00 which petitioners had returned as aforesaid, $12,600.00 which the petitioners had actually received from HC&D during the calendar year 1949 upon the basis of black sand removed during 1949.

Y. In their joint income tax return for the calendar year 1950, the petitioners reported as the sales price of black sand under the Agreement of September 4, 1945, a long-term capital gain of $8,543.29, which purported to be 50 per centum of the $19,126.57 that HC&D determined was due to the petitioners under the contract and payable, until May 19, 1950, upon the basis of black sand removed monthly during 1950. Commencing June 20, 1950, payments were made pursuant to the agreement between HC&D and taxpayers which is Exhibit XII. Petitioners inadvertently omitted from gross income reported for 1950, one monthly payment of $2,040.00 which they received during 1950.

Z. The Commissioner of Internal Revenue determined that the moneys which HC&D paid to petitioners during 1950 pursuant to the Agreements of September 4, 1945, as amended, and May 19, 1950, were ordinary income and substituted for the $8,543.29 which petitioners had reported as a long-term capital gain $19,867.70, which comprises $19,126.57 that the petitioners actually received during 1950 on account of the black sand from HC&D and payable upon the bases of the Agreements of September 4, 1945, and May 19, 1950, both aforesaid, and $741.13 of the $753.78 interest which the petitioners

actually received during 1950 pursuant to the Agreement of May 19, 1950.

AA. Petitioners duly filed with the Collector of Internal Revenue, District of Hawaii, claims for the refund of income taxes allegedly overassessed and overpaid for the calendar years 1948, 1949 and 1950, in the amounts respectively of $1,656.92, $1,657.22 and $2,827.70, on the ground that they had erred in including in their gross incomes for the calendar years aforesaid, long-term capital gains which they had purportedly realized during a calendar and taxable year prior to 1948, namely, during the calendar year 1945.

BB. The petitioners had not claimed, and the Commissioner of Internal Revenue has not allowed, in the determination of the petitioners' taxable net income for the calendar years 1948, 1949 and 1950, any depletion of natural deposits, as provided in any provision of the Internal Revenue Code.

CC. Attached hereto as Exhibts XIII, XIV and XV are the tax returns filed by the petitioners for the calendar years 1948, 1949 and 1950 respectively.

Dated: Honolulu, T. H., July 15, 1954.

/s/ FRANK D. PADGETT,
Counsel for Petitioners;

/s/ DANIEL A. TAYLOR,
Chief Counsel, Internal Revenue Service, Counsel for Respondent.

Filed at hearing July 22, 1954.

[Title of Tax Court and Cause.]

MEMORANDUM FINDINGS OF FACT AND OPINION

Respondent determined deficiencies in petitioners' income tax for the years and in the amounts as follows:

Year	Amount
1948	$2,784.52
1949	2,016.86
1950	4,759.92

The primary question presented is whether for each of the taxable years involved the payments received by petitioners under certain written agreements were proceeds from the sale of a capital asset or royalty payments taxable as ordinary income. Alternatively, if the latter, whether petitioners are entitled to depletion deductions and, if the former, whether the gain is taxable in 1945, which year is barred by the statute of limitations.

Petitioners claim they are entitled to a refund for the taxable years 1948, 1949 and 1950 in the amounts of $1,656.92, $1,657.22 and $2,827.70, respectively.

Findings of Fact

The stipulated facts are found accordingly.

The petitioners, husbands and wife, are and were at all material times herein, citizens of the United States and residents of the city and county of Honolulu, Territory of Hawaii. They filed their joint

individual income tax returns for 1948, 1949 and 1950 on the cash basis with the collector of internal revenue for the district of Hawaii.

At the beginning of the taxable year 1948, petitioners were the owners of lots 822 and 824, which were adjoining, Makiki Round Top Lots, Honolulu. Lot 824, containing approximately three acres of land, was acquired by petitioners in December, 1932. In September, 1937, petitioners erected their home on lot 824 and have occupied it continuously since its erection. Lot 822, containing approximately 2.97 acres, was purchased by petitioners at public auction in February, 1938, for the sum of $8,150, subject to the Hawaiian Organic Act and Chapter 54, Revised Laws of Hawaii, 1935. The lots were situated on a ridge or hillside, and portions of the lots were so steep as to require extensive grading before they could be improved by buildings. By virtue of quarrying in the area surrounding lots 822 and 824, petitioners were aware that portions of their land contained black sand, a volcanic deposit or material used in the construction of cinder and concrete building blocks.

The Honolulu Construction and Draying Company, Limited, hereinafter referred to as Draying Company, is a Hawaiian corporation engaged in business as a general construction contractor and manufacturer of tile.

In the fall of 1944, Draying Company approached petitioners with an offer to purchase that portion

of lot 824 unessential to petitioners' homesite and the corresponding portion of lot 822, totaling approximately 4.4 acres, each lot being a source of black sand. In preparing the deed of sale it was ascertained that petitioners had not perfected title to lot 822 by erecting a residence upon the premises, as required by law. It was also ascertained that the Hawaiian Organic Act and the statutes of the Territory of Hawaii governing the sale, lease or disposition of public lands permitted the lots to be used for residential purposes only, and prohibited, without the written consent of the Commissioner of Public Lands and the Governor of the Territory of Hawaii, such land being contracted in any way, directly or indirectly, by process of law or otherwise, conveyed, mortgaged, leased or otherwise transferred to, or acquired or held by or for the benefit of, any alien or corporation.

By a letter dated November 29, 1944, petitioners requested the permission of the Commissioner of Public Lands to assign the lower portion of lot 822, still unimproved, to Draying Company on the condition that a house be constructed thereon or a $2,500 bond be posted. Permission was denied on the ground that under the land patent laws, lot 822 was restricted to residential use and commercialization of a portion of the lot could not be permitted in order to erect the required dwelling.

Subsequent to November, 1944, petitioners and officers of Draying Company conceived a plan by means of which the latter could obtain the black

sand which it needed for commercial purposes and petitioners could fulfill their obligations of the 1938 agreement of sale with respect to lot 822, namely, the erection of a dwelling house upon the premises. Draying Company employed Rosewell Towill, an engineer and surveyor, to determine by survey the volume of black sand contained in the lower portions of lots 822 and 824 which it was economically feasible to remove from such sand area, while at the same time leaving the area graded for use as a subdivision. Such subdivision grading was to conform to the requirements of the City Planning Commission, city and county of Honolulu.

Towill's survey estimated that there were approximately 250,000 cubic yards of black sand beneath the surface of approximately 192,000 square feet of the so-called sand area, which constituted the minimum amount that would have to be removed in order to grade for the subdivision and to install roadways therein. Towill's survey further estimated that it would cost approximately $32,000 to grade the area conformable to the subdivision requirements after removal of the overburden and the installation of a water pipeline and an access road over the land of an abutting owner.

On September 4, 1945, petitioners and Draying Company entered into a written agreement which provided in pertinent part as follows:

This Agreement made this 4th day of September, 1945, by and between Louis L. Gowans and Helen

T. Gowans, of Honolulu, City and County of Honolulu, Territory of Hawaii, hereinafter called the "Seller," and Honolulu Construction and Draying Company, Limited, a Hawaiian corporation, hereinafter called the "Buyer."

Witnesseth: That

Whereas the Seller is the owner of or has a certain interest in Lots 822 and 824 of the Makiki Round Top Lots; and

Whereas a portion of said two lots comprises an area of approximately 192,000 square feet, hereinafter called the "Sand Area," as shown on a survey recently prepared by R. Towill; and

Whereas, Buyer has estimated that the Sand Area has within it approximately 250,000 cubic yards of black sand which the Buyer wishes to acquire for business purposes; and

Whereas, it is feasible and desirable to remove approximately 250,000 cubic yards of black sand from the Sand Area, and with proper grading thereafter to leave the Sand Area in a condition practicable and usable for home building sites, provided a 30-foot roadway can be obtained over and across certain intervening land owned by Fusao Hasegawa and Yoshiko H. Eguchi leading from the said area out to Round Top Drive; and

Whereas the Seller is presently negotiating with said Hasegawa and Eguchi for such a 30-foot roadway; and

Whereas the Buyer is ready and willing either to buy the interest of the Seller in the land comprising the Sand Area, or to quarry, buy and haul away black sand therefrom, and the Seller is ready and willing to sell same subject to prior consent thereto being given by the Commissioner of Public Lands, upon the terms and conditions hereinafter set forth;

Now Therefore, in consideration of the premises and the agreements hereinafter set forth on the part of the Seller and Buyer to be observed and performed, the Seller and Buyer agree as follows:

The Buyer hereby convenants and agrees to and with the Seller, his heirs and assigns:

1. To procure, at its own expense, a survey plan of subdivision of the Sand Area locating and showing thereon also a 30-foot roadway leading from the Sand Area over and across land owned by said Hasegawa and Eguchi to Round Top Drive;

2. With the consent of the Commissioner of Public Lands first obtained, to purchase all the right, title and interest of the Seller in and to the Sand Area, and to pay the Seller therefor the purchase price of Fifty Cents (50c) per square foot of land within the Sand Area according to said survey;

3. If the consent of the Commissioner of Public Lands to purchase the said interest of the Seller in and to the Sand Area cannot be obtained, but if permission to quarry and withdraw black sand from

the Sand Area is obtained within a reasonable time after the date hereof, then the Buyer will quarry and haul away from the Sand Area approximately 250,000 cubic yeards of black sand and will pay Seller therefore at the rate of Forty Cents (40c) per cubic yard for all black sand so withdrawn, on the following terms:

(a) To pay the Seller on or before the 15th day of each month for all black sand withdrawn during the month prior thereto;

(b) To keep accurate books of account and upon request to permit the Seller to examine the same;

(c) To save harmless the Seller from all loss, costs, damages, claims or suits of whatsoever nature resulting directly or indirectly from the operation of quarrying and removing black sand;

(d) Within five (5) years from the date hereof to quarry and remove approximately 250,000 cubic yards of black sand from the Sand Area;

* * *

Draying Company further agreed that upon removal of the black sand as provided above, it would, before the expiration of five years, complete the grading of the subdivision lots in accordance with plans approved by the City Planning Commission and also grade and pave an access road and install a water pipeline to be available to abutting property owners.

In September, 1945, preliminary approval for the subdivision and the grading levels was obtained from the Planning Commission.

In order to aid petitioners in perfecting their title to lot 822, Draying Company agreed to build a house thereon.

Petitioners executed a noninterest-bearing mortgage to Draying Company to secure the transaction. Construction of the house began in January, 1946, and on completion in May of the same year a land patent for lot 822 was issued to petitioners. The house cost $19,322.81 to build. Draying Company was reimbursed through credits to petitioners' account as royalties were earned. Payment of the total amount was completed in May, 1948.

Because of the delay until May, 1946, experienced by the petitioners in perfecting their title to lot 822, the corporation was delayed until July 1, 1946, in commencing performance under the 1945 agreement. In the removal of the black sand Draying Company was permitted to take quantities below the grade level where it was of usable quality and to fill the resulting holes to grade level with nonusable material.

In August, 1947, petitioner executed a note with the Bishop National Bank of Hawaii, promising to pay $70,000 in monthly installments of $1,050 each. In September, 1947, petitioners assigned to the Bishop National Bank of Hawaii their rights in the

1945 agreement with the corporation as security for the $70,000 note. Draying Company was willing to make the payments to the bank at such uniform rate since the parties had an oral understanding that production would be kept at an even pace over the five-year period called for by the 1945 agreement. Draying Company requested an extension of the five-year period for removal of the sand from September 4, 1945, to five years from July 1, 1946, when effective removal operations actually began as a result in the delay of petitioners' perfecting title to lot 822.

On May 19, 1950, petitioners and Draying Company entered into a written agreement which provided in pertinent part as follows:

This Agreement, made this 19th day of May, 1950, by and between Honolulu Construction and Draying Company, Limited, a Hawaiian corporation, of Honolulu, T. H., hereinafter called the "Buyer," of the first part, Louis L. Gowans and Helen T. Gowans, husband and wife, of Honolulu aforesaid, hereinafter called the "Sellers," of the second part,

Whereas, the Buyer and the Sellers made and executed a certain agreement dated September 4, 1945, unrecorded, hereinafter called "sand agreement," in which agreement the Buyer was given the right and has agreed to take approximately 250,000 cubic yards of black sand from a 4.433 acre area known as the Sand Area being a portion

of Lots 822 and 824 of the Makiki Round Top lots, Honolulu, T. H., being also a certain portion of L.P. Grants 11315 and 6815, area 4.433 acres, as more particularly described in a certain mortgage made by the Sellers to Bishiop National Bank of Hawaii at Honolulu, dated August 21, 1947, recorded in the Hawaiian Registry of Conveyances in Book 2064, page 116, owned by the Sellers; and

Whereas, under said agreement the Buyer is authorized and is hereby authorized to enter upon and to take and remove therefrom Black sand on payment of a royalty of forty cents (40c) per cubic yard for black sand so removed, and is obligated to construct certain improvements on the said lands after removal of the black sand; and

Whereas, the said sand agreement as amended (by unrecorded amendment) provides for removal of the black sand and completion of certain improvements on or before July 1, 1951; and

Whereas, it has become essential in the interests of the Buyer's business and necessary to its business program in connection with its use of black sand that the Buyer have an extension of one year within which to exercise its rights, take black sand and to complete construction of the improvements provided for in the said sand agreement; and

Whereas, the Buyer still has the right and obligation to remove approximately 133,000 cubic yards of black sand upon royalty payment of forty cents (40c) per cubic yard; and

Whereas, the Sellers desire to obtain a loan from the Bishop National Bank of Hawaii at Honolulu, hereinafter referred to as the "Bank," in the amount of Forty-eight Thousand Nine Hundred Sixty Dollars ($48,960.00); and

Whereas, the Sellers are willing to grant an extension of one year to enable the Buyer to exercise its rights and perform its obligations under the sand agreement upon the following terms and conditions:

Now Therefore, in consideration of the premises and of One Dollar ($1.00) each to the other paid, the receipt whereof is hereby acknowledged, and of the terms and agreements on the part of the Buyer and Sellers hereinafter set forth to be observed and performed, the Buyer and the Sellers do hereby mutually agree that the above mentioned sand agreement dated September 4, 1945, be and the same is hereby amended on the following terms and conditions:

(a) The time for completion of the provisions of the said sand agreement is hereby further extended for one year from July 1, 1951, to and including July 1, 1952;

(b) The Sellers will execute and deliver to the Bank their joint and several promissory note dated May 19, 1950, in the principal amount of $48,960.00 payable on demand after date with interest at the rate of three per cent (3%) per annum payable

monthly on diminishing balances of principal, which note shall be endorsed by the Buyer:

(c) As further consideration for the one year extension, Buyer agrees to pay the interest on the unpaid balance of principal of said note accruing after the 19th day of May, 1950, and real property taxes attributable to the said 4.433 acre sand area for the period May 1, 1950 to June 30, 1952:

(d) Commencing June 20, 1950, all royalty payments for black sand removed from said 4.433 acre sand area are hereby irrevocably assigned to the Bank as security for the repayment of said note and shall be made by the Buyer to the Bank at the rate of $2,040.00 per month and applied by the Bank on principal against the above-mentioned note; and upon payment in full of said note all further payments of royalty shall be made to the Sellers:

* * *

In order to meet the deadline of July 1, 1952, as set forth in the above agreement, Draying Company, in 1952, rented extra land and stockpiled approximately 100,000 cubic yards of black sand.

In 1952 Draying Company finished its operation of removing black sand from petitioners' property. Sand removed and payments made therefor during the years 1947 to 1952, inclusive, are as follows:

Years	Cubic Yards	Cash Payments
1947	35,897.47	$ 14,358.98[1]
1948	30,694.50	15,463.83[1]
1949	40,356.25	12,600.00
1950	44,692.25	19,126.57[2]
1951	16,414.50	24,480.00
1952	81,955.03	13,974.62
Total	250,010.00	$100,004.00

The above payments were charged on the books and records of Draying Company to royalty accounts either as prepaid or accrued, dependent upon the amount of black sand actually removed during the period of payment. In its correspondence with petitioners concerning payments Draying Company regularly referred to the payments as royalties.

On their income tax returns for 1948 to 1950, inclusive, petitioners reported the respective amounts of $14,653.60, $12,600, and $17,086.57 as long-term capital gain from the sale of a capital asset taxable at the rate of 50 per centum. In determining his deficiency respondent increased the amounts reported and held that the full amounts were taxable as ordinary income.

For each of the taxable years 1948, 1949, and 1950, petitioners did not claim and respondent did not allow any amount for depletion of the black sand.

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[1]As received by petitioners: $13,247.18 (1947); $16,575.63 (1948).

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[2]Commencing June 20, 1950, payments were made by Draying Company pursuant to the agreement of May 19, 1950.

During each of the taxable years 1948, 1949, and 1950 petitioners retained an economic interest in the black sand in place contained on their lots.

In the taxable years 1948, 1949, and 1950, the petitioners received from their black sand contracts the respective amounts of $16,575.63, $12,600, and $19,867.70, which are taxable as ordinary income.

Opinion

LeMire, Judge:

The first question presented is whether for each of the taxable years involved the amounts received by petitioners from Draying Company were taxable as capital gain or as ordinary income. Petitioners contend that under the agreement of September 4, 1945, as amended by the agreement of May 19, 1950, they sold their interest in 250,000 cubic yards of the black sand contained in the so-called sand area of lots 822 and 824 and hence were entitled to treat the proceeds received as capital gain. Respondent contends that petitioners retained an economic interest in the black sand and that the payments for the extraction thereof constituted ordinary income.

Since the filing of the briefs herein this Court has rendered an opinion in the case of Crowell Land & Mineral Corp., 25 T.C. 223, on appeal C.A. 5, involving a similar factual situation with respect to sand and gravel. See also, Arthur S. Barker, 24 T.C. 1160, on appeal C.A. 2. We held that the proceeds received under the facts there in

controversy were taxable as ordinary income. We are of the opinion that the material facts in the instant case are not distinguishable from the facts in the Crowell case; therefore, that case is controlling here. Accordingly, we sustain the respondent's determination that the proceeds received by petitioners are taxable as ordinary income.

Petitioners' alternative contention is that if the proceeds constitute ordinary income they are entitled to a deduction of "statutory" depletion in each of the taxable years. While petitioners assigned as error the failure to allow depletion, although none was claimed on the returns filed, petitioners present no such argument on brief, and they may be deemed to have abandoned such contention. Assuming, however, there has been no intentional abandonment of the issue, we find no merit in the contention. There is no evidence relative to discovery depletion. It was not until 1951 that percentage depletion with respect to sand and gravel was given statutory recognition. Section 319(a) of the Revenue Act of 1951 amended section 114(b)(4) of the Internal Revenue Code of 1939, relating to percentage depletion, so as to include sand and gravel, and by section 319(c) the amendment was made effective as of January 1, 1951.

Decision will be entered under Rule 50.

Received May 17, 1956.
Filed May 31, 1956, T.C.U.S.
Entered June 1, 1956.
Served June 1, 1956.

The Tax Court of the United States
Washington

Docket No. 50427

LOUIS L. GOWANS and HELEN T. GOWANS
(Husband and Wife),

Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

DECISION

Pursuant to the Court's Memorandum Findings of Fact and Opinion, filed May 31, 1956, the respondent filed a computation which the petitioners agree is in accordance with the opinion. Therefore, it is

Ordered and Decided: That there are deficiencies in income tax for the taxable years 1948, 1949, and 1950 in the respective amounts of $2,784.52, $2,016.86, and $4,759.92.

[Seal] /s/ C. P. LeMIRE,
Judge.

Entered July 5, 1956.

Served July 6, 1956.

In the United States Court of Appeals
For the Ninth Circuit

No. 50427

LOUIS L. GOWANS and HELEN T. GOWANS,
Husband and Wife,

Petitioners on Review,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent on Revenue.

PETITION TO REVIEW DECISION OF THE TAX COURT

Now come Louis L. Gowans and Helen T. Gowans, husband and wife, by Frank D. Padgett, their attorney, and petition the United States Court of Appeals for the Ninth Circuit for a review of the decision of the Tax Court of the United States rendered and entered on July 5, 1956, in cause No. 50427 on the docket of said Tax Court wherein they were petitioners and the Commissioner of Internal Revenue was respondent, and in support of their petition respectfully show this honorable court as follows:

Venue

The petitioners are and were individual and inhabitants of the judicial circuit of this honorable court. The income tax returns of the petitioners for each of the taxable years 1948, 1949 and 1950 were filed in the office of the Collector of Internal

Revenue for the District of Hawaii, which office is and at the time the said returns were filed was located at Honolulu and within said judicial circuit.

The respondent is the duly appointed, qualified and acting Commissioner of Internal Revenue of the United States, holding his office by virtue of the laws of the United States.

Prior Proceedings

The Commissioner determined the deficiencies in income tax for said taxable years as follows:

1948	$2,784.52
1949	2,016.86
1950	4,759.92

Petitioners, on the other hand, claimed that they had made overpayments in the years in question as follows:

1948	$1,656.92
1949	1,657.22
1950	2,827.70

Petitioners filed their petition with the tax court of the United States in order to determine the controversy. The hearing of said petition by the Tax Court was held in Honolulu, Hawaii, on July 22, 1954. On May 31, 1956, the tax appeal court promulgated its findings of fact in opinion on said petition upholding the respondent's contentions.

Nature of the Controversy

This case arises out of respondent's determination of deficiencies in petitioners' income tax return for the calendar years 1948, 1949, and 1950 respectively. The specific income items in question were monies received by petitioners during those years on account of black sand, a mineral, removed from their land under contracts dated September 4, 1945, and May 19, 1950, with the Honolulu Construction & Draying Company, Limited.

Petitioners claim that the sand was a capital asset sold in place by them, the receipts for which were long-term capital gains under the then Section 117 of the Internal Revenue Code.

Respondent contends that the agreements were in the nature of a lease, that petitioners retained an economic interest in the sand and that the receipts were ordinary income under the then Section 22, Internal Revenue Code.

Petitioners have filed claims for refund of taxes paid on the sand receipts during the years in question, on the ground that the sale occurred in 1945 and that since no down payment was made that year, they erred in not returning the whole price of the sand as capital gain in that year pursuant to the then Section 44 (b) of the Internal Revenue Code.

Wherefore petitioners ask that the decision and order of the Tax Court of the United States be reversed by the United States Court of Appeals

for the Ninth Circuit and that a transcript of the record be prepared in accordance with law and with the rules of said court and transmitted to the clerk of said court for filing, and that appropriate action be taken to the end that errors complained of may be reversed and corrected by said court.

Dated: Honolulu, Hawaii, July 18, 1956.

/s/ FRANK D. PADGETT.
Attorney for Petitioners on Review.

ROBERTSON, CASTLE & ANTHONY,
Of Counsel.

Received and Filed July 20, 1956, T.C.U.S.

[Title of Court of Appeals and Cause.]

STATEMENT OF POINTS ON APPEAL

Petitioners say that in the record and proceedings before the Tax Court of the United States and in the decision and final order made and rendered in said cause by the Tax Court, manifest errors occurred and intervened to the prejudice of the petitioners as follows:

(1) The Tax Court erred in not holding as a matter of law that the agreement of September 4, 1945, constituted a sale of the black sand in place and that therefore petitioners thereafter retained no economic interest in such sand.

(2) The Tax Court erred in holding as a matter of law that economic interest was retained in the sand after the agreement of May 19, 1950, by petitioners.

(3) The Tax Court erred in not holding as a matter of law that since the agreement of September 4, 1955, was a sale and no initial payment was then made, petitioners should be refunded taxes paid in 1948, 1949, and 1950 on account of income received from the sand.

(4) The Tax Court erred in holding as a matter of law that the petitioners retained an economic interest in the black sand present in place on their lots in 1948, 1949, and 1950.

(5) The Tax Court erred in holding as a matter of law that the receipts from black sand in 1948, 1949, and 1950 by petitioners in the amounts of $16,573.63, $12,600.00 and $19,867.70, respectively were taxable as ordinary income.

(6) The Tax Court erred in failing to hold as a matter of law that since the petitioners received the total amount of $48,960.00 for the black sand remaining in place on their premises on May 19, 1950, through the device of a bank loan which the Honolulu Construction & Draying Company, Limited, guaranteed, that they thereafter retained no economic interest in the sand.

(7) The Tax Court erred in sustaining respondent's determination of additional taxes due in 1948, 1949 and 1950.

Dated: Honolulu, Hawaii, July 18, 1956.

/s/ FRANK D. PADGETT.
Attorney for Petitioners on Review.

ROBERTSON, CASTLE & ANTHONY,
Of Counsel.

Received and Filed July 20, 1956, T.C.U.S.

In the Tax Court of the United States

Docket No. 50427

LOUIS L. GOWANS and HELEN T. GOWANS,

Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

District Court, Federal Building,
Honolulu, T. H.,

Thursday, July 22, 1954.

The above-entitled matter came on for hearing, pursuant to notice to the parties, at 9:30 o'clock a.m.

Before: Honorable Clarence P. LeMire, J.,
Presiding.

Appearances:

FRANK PADGETT, ESQ.,
For the Petitioners.

DONALD P. CHEHOCK, ESQ.;
(HON. KENNETH W. GEMMILL,
(Acting Chief Counsel, Bureau of Internal Revenue),
For the Respondent.

PROCEEDINGS

The Clerk: The next case is the appeal of Louis L. Gowans and Helen T. Gowans, Husband and Wife, No. 50427.

Will you state your appearances for the record?

Mr. Padgett: Frank Padgett for the petitioners.

Mr. Chehock: Donald P. Chehock for the respondent.

The Court: Is there a stipulation of facts to be filed in this case?

Mr. Padgett: Yes, there is, your Honor. Mr. Chehock has the original.

Mr. Chehock: Your Honor, there is a written stipulation of facts, which both parties would like to file at this time, which includes Exhibits I to XV, inclusive.

The Court: Very well, the stipulation with the exhibits attached is received in evidence.

(The stipulation with exhibits attached was thereupon received in evidence.)

The Court: You may proceed with your statement, Mr. Padgett:

OPENING STATEMENT ON BEHALF OF PETITIONERS

Mr. Padgett: Your Honor, this is a case, which boils down simply to a dispute between the petitioners and [3*] the Government as to whether a transaction involving certain minerals, to wit: black sand, was a sale of that mineral in place, or was a lease or royalty agreement, which would make it ordinary income.

The stipulation of facts reveals the various matters that were done, and the documents which were signed, and many of the other things that were done, and we have some additional evidence to present on the subject; and if time permits, we would ask the Court if we could take the Court up to the premises in question, and give the Court a view of the premises. The reason for that is, your Honor, that, in a case like this, it is very easy to think of the property involved as being like a quarry or mine or a hole in the ground. This is a little different situation, in that this is a section cut out of the mountain, and graded and made into residential property.

The Court: Well, during the recess, the Court has visited some of those black sand deposits up on the Big Island. Would that give me an idea of what they are?

*Page numbering appearing at top of page of original Reporter's Transcript of Record.

Mr. Padgett: I don't believe so, your Honor. This is a little different situation. I think the witnesses will explain it to you as we go along, then your Honor can decide whether it would be of any value to the Court to visit the property.

The Court: Well, I think I will hear the testimony, [4] and after we conclude the case, if I reach the conclusion that it might be beneficial, and we have time this afternoon and it is not too distant, we might go out and take a look at it.

Mr. Padgett: Very well, your Honor.

The Court: You may make your opening statement, Mr. Padgett.

Do you have anything that you want to add to that, Mr. Chehock?

Mr. Chehock: No, I do not have anything to say.

The Court: I thought you might express some view as to whether it would be beneficial to the Court to view the premises?

Mr. Chehock: Petitioners' counsel asked me about that, your Honor, and I have told him I would have no objection whatever. I do have some doubt about whether it would be helpful, or not.

The Court: Very well. The Court will be very glad to have a brief statement of your facts in the case.

Mr. Padgett: Your Honor, this is a case in which the petitioner was the owner of certain property, which he had purchased, two lots, one by deed of conveyance and one direct from the Territory of Hawaii.

The title to those premises was by statute of [5]

the Hawaii Organic Act, Section 73-B, Chapter 54 of the Revised Laws of Hawaii, of 1945, and the premises had to be used for residential purposes.

Moreover the Organic Act prevents the sale of such land to any alien or corporation.

Sometime in 1944, he was approached by the Honolulu Construction and Draying Corporation, who were interested in the black sand on the premises.

Now, black sand is volcanic deposit, which looks like cinders, but is an organic type mineral, and is used very extensively here in construction for cinder blocks, things of that nature.

There was a considerable deposit on this land. This particular area, on the mountainside is very steeply sloped, so that it was incapable of having residences constructed at that time on the particular portion of the premises where the black sand deposit was.

The petitioners were approached by the Honolulu Construction and Draying Company, which makes cinder blocks, and do construction work, and was very interested in this material, with the idea that they would purchase this land.

This was agreeable to the petitioners, and the matter was turned over to the attorney for the Honolulu Construction and Draying Company to prepare a deed. The attorney for the Honolulu Construction and Draying Company [6] would not prepare the deed, because of the restriction of the land for residential purposes and the restriction against a corporation owning the land, preventing

the Honolulu Construction and Draying Company from taking title.

In addition, the second of the two lots purchased did not as yet have a dwelling constructed thereon. All the petitioners had was a special sales agreement, which made it necessary that a dwelling be constructed on the land.

The petitioners wrote to the Commissioner of Public Lands of the Territory of Hawaii, asking permission to make a sale to the Honolulu Construction and Draying Company. The exchange of correspondence is attached as an exhibit to the stipulation. They were turned down. This was in late 1944.

Thereafter, in 1945, pursuant to a conference between Mr. Bush of the Honolulu Construction and Draying Company, and Mr. Gowans, the petitioner, a scheme was hit upon of a sort of two-stage transaction, whereby the Honolulu Construction and Draying Company would enter into an agreement to take out the black sand on the premises and leave the land graded for a subdivision, so that the petitioners might be able to sell off the land, itself.

The only thing we are concerned with here in this case is the black sand. This was turned over to a surveyor, Mr. Towill, and Mr. Towill made a survey, and determined the [7] amount of black sand available, determined the feasibility of a subdivision, and they prepared preliminary subdivision plans, which included also the opinion that it was necessary for a right-of-way to be obtained from the adjoining property owner, in order to put a

road into the premises, if there was to be a subdivision there. That was a requirement of the Planning Commission.

Mr. Bush of the Honolulu Construction and Draying Company negotiated with the owner of that land, and obtained the right-of-way. Then in early September of 1945, an agreement was entered into between the Honolulu Construction and Draying Company and the petitioner.

Now, that agreement provides that, as the black sand is taken out, the petitioners will be paid by the Honolulu Construction and Draying Company some forty cents a cubic yard, and they are to complete taking it out within five years.

Now, the reason for that, it is out contention, and by our evidence we will seek to establish that the time limitation was in order to enable them to go ahead with the subdivision. In other words, there wouldn't be any use in making an agreement to take out the sand and make a subdivision, if they didn't take out the sand; so there was a time limitation put on it; and the agreement also recited the necessity of obtaining the right-of-way [8] and other pertinent facts.

Now, at the time, the petitioners had not yet perfected title to one of the lots; so the first thing that was done was that the Honolulu Construction and Draying Company, at a cost to itself of approximately $19,000, built a residence for them on a portion of the lot. They then were able to obtain a land patent on the area, that then delayed the commencement of the operations about a year.

Then the Honolulu Construction and Draying Company went on what is called the sand area and started taking out the sand. This was sometime in 1947.

As they began to remove the sand, they credited forty cents per cubic yard against the $19,000-some odd, that had been expended in constructing the residence.

Shortly before they finished taking all of that off, the petitioners entered into an agreement with the Bishop Bank, whereby they borrowed a substantial sum of money, and obligated themselves to pay $1,050 per month to the bank. This was early in 1947, when they made the note to the bank, but early in 1948 the bank began to pay at the rate of $1,050 a month, regardless of the amount of sand taken out; and during that period Honolulu Construction and Draying Company was paying for more than the sand taken out. In other words, the sand was always behind the payments to the [9] bank.

That situation pertained until May or June of 1950, when the petitioners entered into another agreement with the Bishop Bank, signed a new note, whereby they obligated themselves to pay $2,040 to the bank. They made an assignment of any proceeds due them under this so-called sand contract with the bank, and at that time the sand contract was modified, to provide that the Honolulu Construction and Draying Company would pay $2,040 per month during the remainder of the agreement.

The agreement was extended approximately one year, or a little better, at that time, and the Honolulu Construction and Draying Company was to pay $2,040 per month, regardless of the amount that they took out.

The Honolulu Construction and Draying Company endorsed the petitioners' note to the bank. They then continued the agreement until 250,010 cubic yards of black sand had been taken out. Now, the original agreement called for approximately 250,000 cubic yards to be removed. At that point, they ceased removing the black sand, and put in the subdivision improvements, and sold the subdivision land to someone else.

That is substantially the way the agreement worked out.

The petitioners returned their receipts under the black sand agreement under the capital gains provision, [10] and the Government contends it was ordinary income. They got receipts in the years 1947, 1948, 1949, 1950, 1951 and 1952, and the years 1948, 1949 and 1950 are involved here.

The Court: Very well.

OPENING STATEMENT ON BEHALF OF THE RESPONDENT

Mr. Chehock: May it please the Court, the petitioners' counsel has gone over the facts that have already been stipulated, and I will try to make a short statement.

The petitioners here, your Honor, two individuals,

are husband and wife, Louis L. Gowans and Helen T. Gowans.

The petitioners' years before the Court are 1948, 1949 and 1950. The years involved, the six years involved with these minerals cover the period of 1947 to 1952, inclusive, in which six years, as counsel has stated, approximately 250,000 cubic yards of sand was quarried and removed from the premises owned by the petitioners.

During the years here before the Court, 1948, 1949 and 1950, there was approximately $16,575 received by the petitioners under these agreements in 1948; $12,600 in 1949 and $19,126 in 1950, for approximately 30,000 cubic yards of black sand extracted in 1948, 40,000 cubic yards extracted in 1949 and approximately 44,000 cubic yards in 1950. [11]

The deficiency here in controversy results from the fact that, as counsel has stated, the petitioners have reported these amounts as long-term capital gains, while the Commissioner has determined them to be ordinary income.

Consequently, the issue before the Court is whether these amounts received by the petitioners from the Honolulu Construction and Draying Company, Ltd., under the agreements of September 4, 1945, and May 19, 1950, during taxable years before the Court, 1948, 1949 and 1950, constitute ordinary income of the petitioners, or, on the other hand, are long-term capital gains as reported.

There are a number of reasons, your Honor, why the payments here do not qualify under the capital

gains provision, as indicated in the pleadings, and which will be fully developed in the briefs.

There is one obvious reason, your Honor, the respondent maintains, why these payments do constitute ordinary income, and that is because this case, in the respondent's view, fits squarely within the import of the oil and gas and mineral lease cases, starting with the Supreme Court case of Burnett v. Harmel, and Palmer v. Bender, and continuing down a long line of decisions, including mineral leases, including the recent Fourth Circuit decision decided in December, 1953, of Hamme [12] v. Commissioner.

While the petitioners tried to distinguish it, it is the respondent's belief, and I believe the Court will so view the evidence, that this is a typical type of mineral leases, wherein the amounts to be received by the petitioners are based upon the amount of sand or minerals extracted; in other words, forty cents per cubic yard; it is a typical type of lease in which the privilege is granted the developer for mining and extracting minerals and, consequently, the payments come within the category of these mineral lease cases, in which the petitioner or taxpayer received royalty payments, and consequently the payments come within the category of ordinary income and not capital gains.

The transaction here, irrespective of terminology, constitutes, in substance, a lease and not a sale; and, therefore, comes within the provisions for ordinary income and not the sale of capital assets and the capital gains provisions.

Many of the facts have been stipulated, your Honor, and have been reviewed generally by the petitioners' counsel, but there are a few facts which I think the Court may wish to keep in mind in weighing the oral testimony, and which I view as pertinent and a major consideration in determining the question before the Court. [13]

First, the payments are based on the quantity of sand removed, forty cents per cubic yard, and hence are in the nature of royalty payments.

The extension agreement of May 19, 1950, refers to the original agreement of September, 1945, and even designates the payments as royalty payments.

The Honolulu Construction and Draying Company, Ltd., treats them on their books as royalty payments and included them within their manufacturing process as a part of the raw material inventory.

Second, the payments are made monthly and as the sand is withdrawn, as is usual in a lease operation.

Third, a five-year period is involved in the quarrying operations. It was originally contemplated to give the Honolulu Construction and Draying Company an opportunity to use and develop the premises, and as a necessary and major consideration in that use.

Consequently, the case, the respondent says does not come within the purview and import of the capital gains provision, as pointed out by the Supreme Court in Burnett v. Harmel.

The capital gains provisions, prior to 1921, if an

asset was sold, irrespective of its character, whether it was a capital asset or not—the profits derived therefrom were taxable as ordinary income. The capital gains [14] provisions were placed in the revenue laws in 1921, because Congress felt there was a hardship resulting from the sale of some of these assets that probably took years to develop, and in which, in a single transaction, in a particular year, created a profit; and as was pointed out in Supreme Court in Burnett v. Harmel, these mineral and oil leases take a considerable period of time, in which the use of the premises was a necessary ingredient in the transaction, were not contemplated at all to be covered in the capital gains provisions.

And, lastly, referring to the extension agreement that the petitioners' counsel has mentioned, which was executed on May 19, 1950, the only consideration flowing to Honolulu Construction and Draying Company was the use of the premises for an additional year in time. No additional sand from the original 250,000 cubic yards was contemplated—only to give them additional time for the use of the premises, and consequently points out clearly the fact that this whole transaction leans in the direction and does, in fact, constitute a lease and use of the premises, and consequently comes within this line of cases heretofore referred to.

I think that, your Honor, is a sufficient statement of the pertinent facts and when viewed with the stipulated facts and oral testimony, I believe will

fully support the respondent's contention, and the soundness of his contention. [15]

The Court: Very well, you may call your first witness.

Mr. Padgett: Your Honor, I am going to call Mr. Bush as our first witness; he is slightly out of order, and it is only because he has another engagement.

The Court: Very well.

LEROY C. BUSH

was called as a witness by and on behalf of the petitioners, and, having been first duly sworn, was examined and testified as follows:

The Clerk: Will you state your name, please?

The Witness: Leroy C. Bush.

Direct Examination

By Mr. Padgett:

Q. What is your occupation?

A. President and general manager of the Honolulu Construction and Draying Company.

Q. What kind of business does the Honolulu Construction and Draying Company run?

A. The company operates a number of businesses; its chief operation is that of rock quarrying, the sale of crushed rock, the production of concrete products, the sale of ready-mixed concrete of every description—concrete products of every description.

Q. Mr. Bush, you are acquainted with the prop-

(Testimony of Leroy C. Bush.)

erty [16] formerly owned by Mr. and Mrs. Gowans, or the property still owned by them?

A. I am.

Q. Are you acquainted with that area generally?

A. Yes.

Q. Now, Mr. Bush, can you tell us a little something about black sand, what it is, what it is like, and what it is used for?

A. This particular type of black sand is a desirable aggregate to be used in the production of lightweight concrete, particularly concrete hollow blocks, which we manufacture and sell, a very desirable so-called lightweight aggregate.

Q. How long has the Honolulu Construction and Draying Company been interested in this particular matter? A. Since 1935.

Q. Have you ever taken out any other deposits on Makiki Roundtop? A. I have.

Q. When did you first start upon that?

A. 1935.

Q. Are there other premises up there, besides the Gowan premises—do they contain this particular material? A. They do.

Q. When did you first begin negotiating with Mr. Gowans for looking towards getting the minerals on their [17] property?

A. We began to get interested in the Gowans' area early in 1944.

Q. When did you first make him an offer, and what was that offer?

(Testimony of Leroy C. Bush.)

A. We approached him and offered to buy a portion of his land in late 1944.

Q. What was his reaction to that?

A. He was very interested in selling.

Q. What did you do after that?

A. We made him an offer, and he proceeded to have the documents drawn up to sell the property to us.

Q. Then what happened?

A. He ran into title difficulties. The title which he had to the property was of such a nature that title could not be transferred to a corporation; so we had to start in all over again.

Q. After you found that out, what was the next step?

A. We were interested in this black sand and not being able to get title, we worked up the idea of putting in—studying the possibility of putting in a suitable subdivision, and excavating and grading and terracing this property in accordance with a subdivision plan or scheme, and we retained a civil engineer, Mr. Towill, to study the feasibility of such a proposition, whereby the property [18] could be terraced and roads put in, subdivided, and as a practical part of that deal, we would remove whatever cinders were in the area, which was the primary things we were interested in.

Q. Were you hoping to do that, yourself, or was Mr. Gowans to do that? When this idea originally came up, was it the idea that Mr. Gowans would make the subdivision, or HC&D would do it?

(Testimony of Leroy C. Bush.)

A. We would make the subdivision, remove the cinders, or the black sand.

Q. Did you talk this over with Mr. Gowans?

A. I did.

Q. What positive steps did you take looking towards setting this thing up?

A. We retained Mr. Towill, and he went to work on a survey, on a contour map.

Q. About when was that?

A. We put Towill to work in April, 1945.

Q. Did you negotiate with anybody else in connection with this scheme? A. We did not.

Q. Was it necessary to put a road in?

A. Yes, sir.

Q. That was through someone else's property?

A. Through the adjoining area, belonging to—from [19] which we had already removed considerable supply of cinders, and across to the Gowans' area had to be through the Hasegawa area.

Access to the Gowans' area had to be through the Hasegawa area, so we negotiated a deal with them, and the plan was drawn up to subdivide both of the properties and remove the black sand from the Hasegawa area also.

Q. Did you carry on the negotiations with Mr. Hasegawa?

A. I did. Wait a minute. Mrs. Hasegawa had died, and with her son-in-law, Mr. Eguchi and his wife, the daughter of Mrs. Hasegawa.

Q. Do you recall when you finally entered into an agreement with Mr. Gowans?

(Testimony of Leroy C. Bush.)

A. September 4, 1945.

Q. I hand you the original of what—a copy which is attached to the stipulation as Exhibit 5, and ask you if that is the agreement which you entered into with Mr. and Mrs. Gowans?

A. This is the agreement.

Q. Mr. Bush, after you had entered into that agreement, what was the first step taken for carrying it out?

A. We soon found out that Mr. Gowans did not have a clear title to one of the properties, in view of the fact—I believe it is referred to as a homestead patent—and it [20] was necessary for him to construct a dwelling on that property before he was in position to let us go ahead.

Q. What did you do in order to enable him to get title?

A. We worked out an arrangement with Gowans, so that the Honolulu Construction & Draying Company built the dwelling, advanced the cost in the nature of an advanced payment on whatever black sand we took.

Q. And you subsequently charged that payment off, as you went along?

A. That's right. We worked off the money we had advanced as we withdrew the black sand.

Q. Now, about the time you finished working this house off—about the time you finished working this house off and began to make payments of $1,050 a month to Mr. Gowans; is that correct?

A. That is correct.

(Testimony of Leroy C. Bush.)

Q. Those were substantially in advance of the amount of black sand that you had removed?

A. That is correct.

Q. Now, what was the reason why Honolulu Construction and Draying Company was willing to make these advances to Mr. Gowans?

A. We had an agreement to buy and remove approximately 250,000 yards of cinders, and it was contemplated that we [21] would remove that at the rate of 50,000 yards a year, and he was expecting payment pretty much on that schedule. However, our use of the black sand turned out to be not quite at the rate that we anticipated, so we made these payments to more or less satisfy that situation.

Q. Was that the understanding at the time you entered into the agreement between yourselves and Mr. Gowans?

A. We had agreed on removing the cinders roughly in five annual equal quantities.

Q. Can you tell us, Mr. Bush, what was the cost of the improvements you placed on the premises, in the form of grading, roads and water mains, and things of that nature?

A. The original estimated cost of these improvements, including water mains, was approximately $40,000.

Q. And what did it actually work out to be?

A. When we got through, it was close to $70,000 —I think about $69,000.

The Court: Did that include the building?

A. No, that did not include the building; that is

(Testimony of Leroy C. Bush.)

just the subdivision, paving, water mains, and so on.

Q. (By Mr. Padgett): How did you handle that expenditure on your books?

A. As we removed this black sand and took it away, we accrued the estimated cost of these improvements, and [22] prorated them on a per yard basis. We started out at fifteen cents a yard, and charged it against the cost of sand removed at that rate, at the beginning.

Q. Mr. Bush, were you able to sell the sand as you removed it?

A. We used it in our own production of concrete hollow blocks.

Q. Did you have use for all of the sand you removed, at the time?

A. It turned out to be that we would take it away lots faster than we could use it.

Q. About how much did you take away, and what did you do with it: did you stockpile it?

A. That's right; we stockpiled it in our concrete products plant out at Kalihi, put it in inventory, and then as it was used in the production of hollow blocks, it was charged out.

Q. About how much did you have stockpiled there at Kalihi?

A. When we got into this last year, we still had something over 100,000 yards to go, so it was necessary for us to acquire land adjoining our operations out there, about three acres, so that we could perform our commitment and take it away, we

(Testimony of Leroy C. Bush.)

stockpiled out there something in excess of 100,000 yards. [23]

Q. You still have some of it on hand?

A. We still have somewhere around 50,000 yards.

Q. Now, at the beginning Mr. Towill made you an estimate, didn't he, of about 250,000 cubic yards?

A. I believe slightly over. It was roughly 250,000.

Q. How much did you actually take out?

A. 250,010 yards.

Q. Was there, on those premises, more usable black sand at that point?

A. Yes. You would have had to change the lay-out, and it was hardly desirable to do so. We had roughly completed the excavation and terracing in accordance with the plan. If you wanted to take more, you would have to revamp the whole thing, and start over again, and possibly create a less desirable layout.

Q. You had definite plans, then, as to what you were removing, and what the area was?

A. Yes. Mr. Towill made a contour survey of the land in its original shape, and designed a feasible, practical, terraced subdivision, and determined the contour of that ultimate plan, and estimated the quantity in between the two.

Q. In order to set it up under Mr. Towill's plan, was it necessary for you to take out any solid rock?

A. We removed—it varied in quality within [24] the area, and we removed the best quality black sand from where it was, then excavated the less

(Testimony of Leroy C. Bush.)

desirable material—some of it was pretty hard rock —over the area, to bring it to the finished grade.

Q. You used that to fill in?

A. That is right.

Q. At the beginning, Mr. Bush, when you first started to get this sand out, or when you first entered into the deal, did you give the treasurer of your company any instructions as to how to set this up on the books?

A. I did. We discussed with him the contemplated method of operation, and I instructed him that we would remove the stuff and put it in inventory and he was to accrue as inventory cost the forty cents a yard to be paid to Mr. Gowans, the excavating and hauling costs to our concrete products plant, and prorate on a per yard basis the anticipated money we would need at the end of having completed all of this—the cost of putting in the improvements.

Q. Mr. Bush, I notice that the agreement of September 4, 1945, is in terms of buyer and seller. Was it your intention to purchase 250,000 cubic yards? A. That is correct.

Mr. Chehock: I object to that as calling for a legal conclusion. These facts speak for themselves as to [25] whether this transaction constituted a sale or a lease.

The Court: Well, the Court is aware of the fact that it is necessarily an opinion of this witness. The document speaks for itself. However, I will permit the answer to remain.

(Testimony of Leroy C. Bush.)

Mr. Padgett: Your Honor, since this objection has been made, I would like to get this in. Mr. Chehock has cited some cases. It is my understanding that the Court has never been bound by the terms of any document, but that the question is the intention of the parties. I don't know how to get to the intention of the parties, except ask him the questions, and bring out the facts.

The Court: Very well, I have permitted the witness to answer.

Mr. Padgett: Will you read the last question back, Mr. Reporter?

(Thereupon, the reporter read the pending question.)

Q. (By Mr. Padgett): Mr. Bush, do you recall at what time you employed Mr. Towill?

A. April, 1945.

Q. Did you give him any instructions as to what he should do, at that time?

A. He was to make a contour map, and study whether or not it was feasible to put a subdivision in this area. [26] The area is pretty steep, on the side of a hill, and I instructed him to go into the feasibility of constructing a division within the area.

Q. Mr. Bush, in late 1944, the Commissioner of Public Lands had refused to allow you to purchase this land, and yet, in the agreement of September 4, 1945, there is the alternative that you are to be allowed to purchase this black sand, and the subdivision deal to be entered into.

(Testimony of Leroy C. Bush.)

Now, why was it that that purchase idea was still in the agreement at that late date?

A. We were still hopeful of clearing title, because our primary interest was to purchase the property, likewise Mr. Gowans wanted to sell; we were still hopeful of clearing title, so we could buy the land.

Mr. Padgett: I have no further questions.

Cross-Examination

By Mr. Chehock:

Q. Mr. Bush, you mentioned that there was some oral understanding, or at least a conversation with Mr. Gowans, to the effect that you would probably extract approximately 50,000 cubic yards a year for a five-year period? A. That is correct.

Q. And was that figure of 50,000 mentioned because you contemplated that was about the amount that you could [27] assimilate and properly use in your manufacturing process?

A. That is correct.

Q. Now, at the end of the five-year period, you had not all of the sand extracted, and so you got this year—this extension period of a year: is that correct? A. Right.

Q. And as that year continued—I mean as the time progressed during that period of a year, you had not used all of the black sand, and so you quarried the property and removed approximately 80,000 cubic yards?

(Testimony of Leroy C. Bush.)

A. I believe that is right; eighty to one hundred thousand.

Q. How long did it take you to extract that eighty thousand to 100,000?

A. I think it was done in the period of about nine months, we had about three months left to get the improvements in.

Q. Nine months to extract the 80,000?

A. Approximately that.

Q. Is that about as fast as you could have extracted it?

A. It was faster than we could. It was a bigger job than we could handle, so we turned the job over to a general contractor to remove it.

Q. How fast would it have been possible for you to [28] have removed 250,000 cubic yards, if you had removed it, not with the thought of assimilating it and using it in your manufacturing processes?

A. The way it turned out, we had been using it at the rate of about 20,000 cubic yards a year.

Q. You could have gone in there and taken it all out and put it in a pile and used it as you wanted it, couldn't you?

A. That is right, but that would have required considerable storage area, and considerable cost.

Q. How long a time would that have taken?

A. If we got enough big equipment in there, we could take it out in six months, I guess.

Q. What you were bargaining for, really, in the way was a time period there of five years, and then an additional year for the use of the premises, and

(Testimony of Leroy C. Bush.)

the development of the property; is that right?

A. The ideal result, as far as our operation was concerned, if we could have taken it from the area and put it right in our plant and not stockpile it at all—that would have been the ideal.

Q. And you needed the use of the premises, so that it would fit in?

A. To save us the cost of acquiring additional land, and rehandling it, and all of the rest. [29]

Q. Mr. Bush, will you describe this property, prior to the time that the sand was extracted?

A. It is a typical cone of volcanic porous ash. There are a number of these flows around here, this is one of them, and just back of it this main Tantalus crater, and when this volcanic activity starts, it is invariably violent, there is gas, and more gas flows up and precipitates into the cone, this porous stuff does, and consequently this material comes out in a liquid mass, and flows down into the lower valley. The cinder cone is a part of the crater, and this is the same material, and it is porous, makes lightweight aggregate for concrete hollow blocks.

Q. Was this property here comparatively flat?

A. No, it was quite steep.

Q. Houses could have been constructed on the sand, could they not?

A. Not economically. The accesses to the area, if you wanted to build a house—the grade is, I would say, thirty to forty per cent, and the construction of roads was quite difficult; economically, it is prohibitive, probably.

(Testimony of Leroy C. Bush.)

Q. It would have required some grading, in order to make it feasible; is that it?

A. I think if you will go out and look at it, that will answer your question. You would almost have to build an elevator to get an automobile down [30] to it.

Q. Will you describe what the property——

A. I will answer your question a little more specifically: If you left the slope, steep as it was, build a road to get to it, and utilize it—that was next to impossible, in my opinion.

Q. Had any houses been built along there without the extraction of the sand?

A. Immediately adjoining the existing highway only.

Q. Then you think it would not be feasible, because of the fact that there would not be access to the highway; is that right? A. That is right.

Q. Its access to the highway had been obtained from these two property owners that you had bought the sand from, would it have been feasible to have built houses on the ground?

A. No, you would still have to extract the sand, lower the grade down, so you could get at it.

Q. How much?

A. I think the average cut in this area, if I remember correctly, is close to forty feet, and at that, we would up—the grade of the road which we built is ten per cent, which is quite steep, even after we removed that much material.

Q. After the sand was removed, then, and prior

(Testimony of Leroy C. Bush.)

to the time you put any improvements on it, will you describe the property? [31]

A. Well, it was the side of this steep, rounded mountain, with a grade of thirty-five to forty per cent, uniform slope.

Q. (By Mr. Padgett): After the sand is removed?

A. Oh, I beg pardon. Before. I thought the question was before.

Q. (By Mr. Chehock): No; after.

A. Oh, after it was removed, as we say in Hawaii, the Mouka, or upper portion, the adjoining portion to the property which Mr. Gowans retained for his own home—that bank stands up there 100 feet, and in front of it is these terraced lots.

Well, the motions I am making here ought to be on TV, to get it on the record. There are these terraced lots, and each lot is different in elevation about eight or ten feet, and then there is a central access road going right up through the middle of it, so that each lot—the lots on the upper side of the road are higher than those on the lower side, and you can look out over them, and each lot was terraced.

We cut it up into lots of 10,000 to 15,000 square feet and left each lot flat.

Q. How did the property look before you had done [32] any terracing or any improving whatever? Just describe the property after you had extracted the sand.

A. We extracted sand to conform to this terrac-

(Testimony of Leroy C. Bush.)

ing, where we could, except in one area that was generally no good, there was hard rock; we left it that way, and removed some of the black sand from the lower area, the quantity which we wanted, that created, well, quite a hole there, and then we took the hard material and filled the hole up, to bring it up to the planned terrace grade.

Q. How big a hole was dug?

A. That hole was about 40 feet wide, 150 feet long and I think we went down about 70 feet.

Q. And then in order to put the property in shape for residential purposes, did you fill that hole?

A. That's right.

Q. What did you fill it with?

A. With material excavated from the adjoining area, the material that wasn't good black sand; we couldn't use it.

Q. That property couldn't have been used for residential purposes, without filling that hole?

A. No.

Q. Is that quite an operation?

A. Well, the contractor did the whole job, took the 80,000 to 100,000 yards—he did all that for a unit [33] figure.

Q. Do you remember about what it cost?

A. He delivered the black sand, excavated it and delivered it to our concrete products plant for $1.10 a cubic yard.

The Court: That included the filling up of the hole?

A. That's right.

(Testimony of Leroy C. Bush.)

Q. (By Mr. Chehock): That took about how many cubic yards? A. Out of that hole?

Q. Do you remember what that cost was?

A. He did all of this—he loaded and hauled the material and delivered it to our plant six miles away—he did all that for $1.10 a cubic yard, including the filling of the hole.

The Court: But you don't know what his total bill was?

A. No, sir.

Q. (By Mr. Chehock): Do you remember approximately? A. Oh, I would say $90,000.

Q. Well, I don't quite understand, if the total improvements cost $69,000—how that fits into the $90,000?

A. That item went into the inventory cost of the [34] black sand, that $1.10.

Q. Putting the property back and filling in the hole, you consider that as part of the cost of the operation?

A. No, he did that for part of this $1.10. Then when he got through we went in and finished it up.

Q. You mean you paid him $1.10?

A. To excavate this material, load it on trucks and deliver it to our stock pile inventory, out at our concrete products plant, and that item went into——

The Court: That was a part of your inventory cost?

A. That is correct.

Q. (By Mr. Chehock): I think you testified there was some more usable sand there.

(Testimony of Leroy C. Bush.)

A. That's right.

Q. Didn't you take most of the usable sand?

A. I would say, economically, we took just about the last yard. There was more there, but it would not lend itself to the proposed development scheme and the cost would have been prohibitive.

Q. Now, the sand that was removed—how did you treat it on your books?

A. The sand that was removed?

Q. Yes. [35]

A. It was stock-piled at our concrete products plant and put in the inventory with all of the costs, including the payment to Gowans, the accrued cost of the improvements which we had to make, and the excavating charges, the trucking charges.

Q. How were they characterized on your books, the payments made to Mr. Gowans? How were the payments made to Gowans characterized?

A. In our records, I believe they were listed as royalties, which is the practice in our operations, in buying rock and sand. That is the procedure that is usually used.

Q. Was there any actual conveyance made to you of the mineral contents of the sand area?

Mr. Padgett: I object.

Q. (By Mr. Chehock): Other than the written agreements of September, 1945, and May, 1950, was there any actual conveyance to you of the mineral contents of the sand bank?

A. Under that agreement, we agreed to buy 250,000 yards of cinders.

(Testimony of Leroy C. Bush.)

Q. You haven't answered my question. Aside from those two written documents, was there any other written agreement or actual conveyance of the mineral contents of the sand area to the Honolulu Construction and Draying Company? [36]

A. That was the basic agreement, and all of the verbiage is in there.

The Court: And that is the only agreement you had?

A. That is the only agreement we had.

Q. (By Mr. Chehock): Did Gowans know there was black sand there before you approached him?

A. Oh, yes.

Q. Did he ever approach you about selling the sand, or extracting it?

A. We were operating all around him, and I think I made the first approach to Mr. Gowans—I am quite sure of that.

Q. Did you already know that Mr. Gowans was interested in selling?

A. I knew he was approached by a competitor.

Q. And did you know that he was interested in having it extracted from his property and making a deal to consummate it? A. Yes, sir.

Q. You knew that prior to the time that you contacted him?

A. Yes, I was quite sure he was interested in selling the black sand off of his property. [37]

Q. Would you be able to state, in cents per cubic yard, approximately what the cost of extracting—

(Testimony of Leroy C. Bush.)

all of the costs that go to remove the sand from the property—would be?

A. State that again, please.

Q. You paid Gowans forty cents per cubic yard for the sand removed. A. Yes.

Q. Do you know about what it cost you to remove that from the property?

A. All of our costs averaged about—somewhere between $1.00 and $1.10. I happen to know that roughly 50,000 cubic yards are still there on the books now at about $1.70.

Q. If the black sand had been avilable where you wouldn't have to extract it, yourself, at that time, would you have been willing to have paid approximately $1.00 or $1.10 per cubic yard?

A. We were primarily interested in getting the black sand at my plant as cheaply as possible. That was chiefly the determining factor.

Q. I don't think you have answered my question.

A. Would you state the question again, please?

Mr. Chehock: Will you repeat the question, Mr. Reporter? [38]

(Thereupon, the Reporter read the pending question.)

The Witness: The material is in very limited supply and this was the best we could get. In fact, the royalty has skyrocketed since then.

Q. (By Mr. Chehock): Have you ever acquired black sand for your company that is already mined and extracted?

(Testimony of Leroy C. Bush.)

A. We got the black sand from the Hasegawa area through an independent contractor, who had extracted the material, paid the royalty to Hasegawa, and delivered it to us, and in fact it so happens that the beginning cost to us was $1.10 back in 1935.

Q. That was the sand already extracted?

A. That's right. He paid the royalty and did all of the work, and delivered the product, all wrapped up, to our plant, at $1.10.

Q. Would you say that was approximately the fair market value of black sand in 1945?

A. No. The price had gone up. That $1.10 was in 1935.

Q. What would it have been in 1945?

A. In 1945, we sold a small quantity of material for $2.50 a yard.

Q. What was the cost to you? [39]

A. In 1945, our cost at our plant was about——

Q. I mean the cost—was there any black sand available, in 1945, which you could have bought, without extracting it yourself—just buy it already extracted? A. We could have.

Q. What was the price at that time?

A. Probably about $2.50 a yard.

Q. And your figure of the cost of extracting this particular black sand was about how much?

A. The cost of extraction?

Q. Yes.

A. And hauling out to the plant was an average of about $1.10. That is an offhand figure.

(Testimony of Leroy C. Bush.)

Q. So you saved in this operation, by this deal you made with the Gowans, over this period of time, approximately the difference between $1.10 and $2.50?

A. Well, that $2.50 is a small quantity proposition. It fould be difficult to fix——

Q. Approximately.

A. The availability of material at that time—that the price could be all the way from $2.00 to $3.00.

Q. Whatever the difference was between forty cents, plus your cost, whch was approximately $1.10, then the going price of black sand already extracted, you saved by the use of these premises, under this deal, didn't you? [40]

A. I don't know. I would answer your question this way: We could have turned the whole deal over to somebody else and probably gotten the material in this quantity, and under this contract, delivered out to our plant for that cost, plus some profit to the contractor, which might have been 25 cents a yard over our cost.

Q. Then you did have a substantial saving by doing it yourself, under this deal with Gowans?

A. Without question.

Mr. Chehock: I believe that is all.

(Testimony of Leroy C. Bush.)

Redirect Examination

By Mr. Padgett:

Q. This extension that was made in 1950, by the agreement of May 19—can you tell me what the origin or the cause or the reason of that extension was?

A. We still had a considerable quantity of black sand to remove, and we were obligated to remove it, and we were running out of time, that we had not yet arranged a stock pile, so we requested Mr. Gowans to give us an extension of time.

Q. How was it that you had not removed the sand up to that time?

A. We didn't use the quantity we anticipated, due to the fact that another aggregate came into the picture from a color angle, namely, limestone, and starting about that [41] time and since then about one-half of our production has been of this other material, limestone, that reduced the anticipated use of the black sand.

Q. Were you delayed, at all, in starting operations on the premises?

A. Just in connection with his clearing title to the land.

Q. Could you tell me about how long that delay was?

A. The record will show that. I think it was about nine months.

Q. About nine months? A. Yes, sir.

(Testimony of Leroy C. Bush.)

Q. Now, Mr. Bush, you were asked some questions about how fast all of that sand might have been taken out. Isn't it a fact that the rate at which you take out sand depends upon the amount of equipment you put into the job?

A. That is correct.

Q. If you had gone up there with enough equipment to remove the 250,000 cubic yards in six or nine months and put that subdivision in in that time, would such operation have been economically feasible?

A. Well, the removal and hauling away and the cost of installing the subdivision, I would say would not have been affected. However, our stockpile cost would have been substantial for the additional sand, and rehandling. [42]

Q. Would you have run into the cost for the additional equipment, in order to remove the black sand in that short period?

A. No; I would say that the actual cost would not have been affected by the shortness of the time.

Q. You would have had to get more land to pile it up?

A. Yes, sir; rehandle it and land rental, and what not, connected with the inventory, which would have been substantially increased.

Q. You have been asked questions about the quantity of black sand available—or about the price of black sand available on the open market in 1945. Was that in any quantity?

A. I had in mind the smaller quantities.

(Testimony of Leroy C. Bush.)

Q. Could you have obtained enough black sand on the open market to have met your needs?

A. No.

Mr. Padget: That is all.

Recross-Examination

By Mr. Chehock:

Q. Mr. Bush, black sand was very much in demand in 1945, wasn't it? A. Yes, sir.

Q. And it was really very desirable ingredient for your manufacturing processes? [43]

A. Correct.

Q. If Mr. Gowans had said to you, or to your company, "You may have the black sand on my property of approximately 250,000 cubic yards, providing that you will see that it is taken off in six months," would you have made the deal with him?

A. No, at that time, I think we could have made a more favorable deal for the adjoining area, probably less quantity, but I would say we could have made a more favorable deal, and that would have kept us going for quite a while.

Mr. Gowans drove a very good bargain.

Q. How could a deal have been made on the adjoining property?

A. There was additional sand available there, there was and still is, in diminishing supply, and the royalty is going up.

Q. But it would have been possible, if you had wanted the sand, to have extracted it?

(Testimony of Leroy C. Bush.)

A. At that time, yes.

Q. If it hadn't been extracted, you would have made some deal possibly with some other folks—if it hadn't been for the fact that you could have made a deal with some other folks, possibly, you would have agreed to take the 250,000 yards in six months, wouldn't you?

A. If it had not been possible? [44]

Q. Yes.

A. I am afraid we would have had to.

Mr. Chehock: That is all.

Mr. Padgett: That is all, Mr. Bush.

The Court: Very well, you may step aside.

(Witness excused.)

The Court: How many witnesses do you have?

Mr. Padgett: I have three more witnesses, your Honor.

The Court: How much time do you think you will need to finish the case?

Mr. Padgett: I imagine three witnesses—this examination has been much more than I thought, but I think we would take about an hour.

The Court: Very well, we will recess for five minutes.

(Thereupon, a brief recess was taken.)

The Court: You may call your next witness.

Mr. Padgett: Mr. Towill.

R. M. TOWILL

was called as a witness by and on behalf of the petitioners, and, having been first duly sworn, was examined and testified as follows:

The Clerk: Will you please state your name, sir?

The Witness: R. M. Towill. [45]

Direct Examination

By Mr. Padgett:

Q. What is your occupation?

A. Civil engineer and surveyor.

Q. How long have you been engaged in that line of endeavor? A. Since 1930.

Q. And in the Territory of Hawaii?

A. Since 1923.

Q. Mr. Towill, are you acquainted with the property owned by Mr. and Mrs. Gowans on Makiki Roundtop, Lots 622 and 624? A. I am.

Q. Have you done any work in connection with those lots? A. I have.

Q. How much, and by whom were you first engaged to work on it?

A. I was employed by Mr. Leroy Bush for the Honolulu Construction and Draying Company.

Q. And you can tell us when that was? Have you any records to show that?

A. On April 2 and 3, 1945.

Q. When you were employed by Mr. Bush, what were Mr. Bush's instructions as to what you were to do? [46]

A. To prepare a contour map, or to compute the

(Testimony of R. M. Towill.)

volume of material in that area, and also to see if it would be feasible to have there a subdivision, or to make a subdivision.

Q. What was the first thing you did in connection therewith?

A. Prepare contour map, as well as take levels —go out and take levels and prepare a contour map.

Q. And when was that?

A. The work was started on April 4, 1945.

Q. You said you were employed to make an estimate of the available minerals, black sand; is that correct? A. That is correct.

Q. When did you make that estimate?

A. I believe it was in June—the latter part of May, or the beginning of June, 1945, after the completion of this contour survey.

Q. And do you recall or do you have anything to show what your estimate of the available black sand in the area in question, the Gowans property, was?

A. My computation shows in the neighborhood of 253,000 yards, which I reported around 250,000 yards to Mr. Bush, from the preliminary estimate and preliminary studies of the grades for a subdivision.

Q. Now, after you made this estimate, what next did [47] you do, in connection with this property?

A. I prepared a subdivision plan.

Q. Can you tell us about when that was?

A. The subdivision plan is dated September 19,

(Testimony of R. M. Towill.)

1945. It was submitted to the Planning Commission at that time, for their approval.

Q. Do you have a copy of the plan which you submitted, and the letter which you submitted, to the Planning Commission, at that time, with you?

A. No; I have a copy of it, I have a copy of the original tracing, from which the prints were made, which were submitted to the Planning Commission.

Q. It is the tracing which you are holding here?

A. That is correct.

Q. And what does that purport to show?

A. The proposed subdivision, portions of lots 822, 823 and 824, Makiki Roundtop lots.

Q. Does it have thereon the contour lines as they then existed? A. It has.

Mr. Padgett: Your Honor, I will offer this map in evidence at this time.

The Court: Is there any objection?

Mr. Chehock: No objection.

The Court: There being no objection, [48] petitioners' Exhibit No. 16 is received in evidence.

(The map referred to was marked Petitioners' Exhibit No. 16 and received in evidence.)

Mr. Chehock: I have no objection to its admission, your Honor, but I do think counsel should furnish us a copy of it or a photostat of it.

The Court: I was going to inquire whether or not you wanted to withdraw this original and substitute a photostatic copy for it, Mr. Padgett?

(Testimony of R. M. Towill.)

The Witness: Your Honor, please, white prints could be made from that in a very short while.

Mr. Padgett: We will do that, your Honor.

The Court: If you do desire to do that and supply counsel for the respondent with a photostatic copy, leave will be given to withdraw the original and substitute a photostatic copy therefor.

Mr. Padgett: Very well. Thank you, your Honor.

Q. (By Mr. Padgett): Do you know the date upon which you submitted the preliminary plans to the City Planning Commission for preliminary approval?

A. It was some time in September, I think the 19th.

Q. Did you receive approval from the City Planning Commission? [49]

A. Yes, I did, preliminary approval from them.

Q. About when was that?

A. That was at the meeting that was held in the middle of September, about the middle of September.

Q. Now, then, after that, did you continue to work in connection with this proposed subdivision, from time to time? A. I did.

Q. How long did that—I mean, when did you do this work, over what period of time?

A. The work was completed in September of 1952. That was my final bill to the Honolulu Construction and Draying Company for services in connection with that project.

Q. Mr. Towill, would it have been feasible to

(Testimony of R. M. Towill.)

subdivide that property, or build houses thereon, without removing the black sand?

A. It would not have, no.

Q. Why is that?

A. Because the property was so precipitous; it had to be lowered in elevation, in order to provide an access road, or a passable road to get into the property.

Q. A passable road to get into the property—who required that? A. How is that?

Q. Who required that there be a passable road to get [50] into the property?

A. That is the rule and regulation of the Planning Commission and the county or the city.

Q. Could you tell us about what the grade was originally on that particular area?

A. I would like to refer to that map. It was about twenty feet in every forty feet; a slope of about one and one-half to one, which is rather precipitous.

Mr. Padgett: I have no further questions of the witness.

Cross-Examination

By Mr. Chehock:

Q. Your name is Mr. Towill?

A. That is correct.

Q. Did Mr. Gowans or Mr. Bush approach you on doing this work of surveying and making the subdivision map?

(Testimony of R. M. Towill.)

A. Mr. Bush, for the account of the Honolulu Construction and Draying Company.

Q. Did Mr. Gowans also see you about it?

A. I don't recall that he did, until near the completion of the project.

Q. Will you just describe the property out there in September, 1945, when you made this contour map? Describe it so that we can get a clear picture of what the property looked like in September of 1945. This is prior to any [51] excavation.

A. May I use this map to illustrate that?

Q. Yes. Remember that when you point to something, that won't go into the record, because it will have to be by word of mouth, and you will have to describe it. A. I realize that.

The Court: Maybe you can hold it back against the wall, so everybody can see it. Is it visible to you people out there?

The Witness: The Makiki Roundtop road, going up the mountain, in the southerly or southwestern section of the property. The balance of the property comprises an area almost L-shaped.

Q. (By Mr. Chehock): Wait a minute. You mean towards the upper portion of the map there, do you?

A. Yes, sir, the upper and northerly part of the property. To the south and west of Mr. Gowans' property there was some property owned by the Hasegawas through which it was necessary to pass, in order to quarry the sand from the Gowans' property.

(Testimony of R. M. Towill.)

Q. Did you say in order to quarry it from there? Did you say it was necessary to pass over this other property in order to quarry the sand; is that what you said?

A. That is correct. The Hasegawa property, and the [52] parcel adjacent to the west of the Gowans' property had been quarried for a period of years in small quantities, and in order to get into the Gowans' property, Mr. Bush negotiated with the Hasegawas for an easement to get into the premises. I don't recall the details, but I know that in the agreement, he agreed, at the completion of the quarrying, to construct a road for the Hasegawas.

In order to subdivide this property, it was first necessary to set a grade along this access road that would not be too steep, in order to gain entrance, and it was also necessary to take out a great volume of sand here, in order to lower the elevation of that property, so that you could get a road into it.

Q. Right there, about how much sand would have to be removed, in order to do that?

A. There was 250,000 yards that was the minimum that they could take out to get grades in there, and their land was so precipitous, originally, that we had to come in there with a horseshoe turn, in order to gain grade, to get into the property.

Q. Are you through? A. Yes, sir.

Q. Well, now, you have explained somewhat, probably, but can you explain in a more general way the description of the property—not as to what

(Testimony of R. M. Towill.)

had to be done, but just a [53] general description of the property?

A. You mean as to the location or the physical character?

Q. Well, as to the physical character.

A. The property is a portion of that Makiki Roundtop ridge that comes down. Along the southerly and westerly side of the ridge, this Tantalus Road, called the Makiki Roundtop Road to Tantalus, goes along the side, from that road it was sloping in this direction (indicating), along the hillside, and up at the same time. It was a hillside covered with what is known as Haleko, which is a kind of shrubbery.

Mr. Chehock: Do you have any questions, your Honor, that you want to ask him?

The Court: I want to get a picture of the lots that are involved, and I think it is fairly clear here now. This blue-marked part down at—is that the south side?

The Witness: Yes.

The Court: And the south side—that is on the property belonging to the Hasegawas?

A. That is correct.

Q. Then when you get over to about this line, what is that line—a pipeline?

A. That is a right of way that went through there for a [54] pipeline, and I believe the electric line also.

Q. When you get to that pipeline, you then get onto the Gowans' property; is that correct?

(Testimony of R. M. Towill.)

A. Yes, sir.

Q. From there on, the rest of this is all—this whole blue-marked part, of course, is all on the Gowans' property?

A. That is correct, and the Gowans' property, your Honor, is covered right here (indicating).

Q. Where is Lot 824? One of those lots is 822 and one is 824. Will you more or less designate those on here for me?

Mr. Padgett: This one here (indicating), your Honor, on the left-hand side of the map is 824, and the one on the right is 822, as I recall.

The Court: And these are subdivision lots?

A. Yes, they are lots.

Q. If you could more or less blue pencil, some way or another way, and then right up to the top or on the bottom, show the lot numbers—will that show on a photostatic copy?

A. It will not, your Honor.

Do you want a photostat or shall I make you a white copy? I can transfer the same coloring to that print that [55] we have here.

The Court: That will be fine. If you will mark these lots in red pencil, that will give me a better idea of the land we are concerned with.

The Witness: Yes, sir.

The Court: The dividing line between Lots 824 and 822 is where?

A. Right here (indicating).

The Court: That is all I have.

Q. (By Mr. Chehock): Mr. Towill, this Exhibit

(Testimony of R. M. Towill.)

16 is merely a proposed subdivision; it would not have been in existence in September, 1945?

A. No, sir.

Q. Did you go out and look the property over in September, 1945?

A. Yes, I did. I took field crews there and made surveys.

Q. Did this sand extend over this property that is marked off in red here, that was ultimately subdivided—did the sand extend over that entire property?

A. It did, that whole area in there was black sand.

Q. And after the Honolulu Construction and Draying Company had extracted the sand from this property, will you describe it, prior to any terracing or any improvements, but [56] after the sand had been extracted; will you describe the property?

A. During the extraction of the sand, I was employed by the Honolulu Construction and Draying Company to give the levels at times, in order that they would extract sand to eventually come to the grade prepared for the subdivision; so that when they finally completed their extraction of sand, the land was in shape for lots and roads.

Q. Now, Mr. Towill, isn't it true, as Mr. Bush has testified, that when he got through there was a great big hole there that had to be filled?

A. That was in the preliminary stages, over in the southerly corner here (indicating).

Q. Will you describe that hole?

(Testimony of R. M. Towill.)

A. I don't know that I was on the premises while that hole was there—personally on the premises.

Q. And the extraction of this sand, necessarily would mean that a large hole would be created on the property, that would have to be filled, in order to complete the subdivision as contemplated under Exhibit 16; is that correct?

A. Not necessarily, sir.

Q. You heard Mr. Bush testify that they did have this big hole, that was about 70 feet, didn't you? A. I didn't hear that.

Q. You weren't out on the property after this sand was [57] extracted?

A. I was there at various times, yes, sir, maybe once a month, sometimes every three months, directing field crews and surveying.

Q. You seemed to know about this big hole. Now, what do you know about it?

A. All I know is hearsay.

The Court: You don't recall having ever seen it?

A. No, your Honor.

Q. Only what Mr. Bush told you, or someone else, is all you know? A. Yes, sir.

Q. (By Mr. Chehock): Were you out there to see that the improvements were made, or did you have anything to do with that?

A. What improvements are you speaking of?

Q. The terracing of the property, the filling in of the hole, leveling it off, and putting on whatever

(Testimony of R. M. Towill.)

was necessary for a complete subdivision as shown in Exhibit 16?

A. These are not the plans that were finally approved by the various departments of the city for the completion of the utilities which were required for this subdivision; that is a set of engineering plans, this is the preliminary plan not the final [58] plans.

Q. When were the final plans drawn up—in 1952?

A. In April of 1952, prior to April of 1952, yes, sir.

Q. Will you describe how they compared to Exhibit 16?

A. Essentially, it is the same. The lots are approximately of the same sizes. The road location is the same as shown on the preliminary plans. The engineering plans show the final details of catch basins, water mains, grades of the road, and curbs and gutters.

The Court: Did you prepare the final plans or were they prepared by the Commission?

A. No, your Honor, I prepared plans which were the routine. The engineers prepared the plans and submitted them to the city, the various departments of the city for their approval and check.

Q. (By Mr. Chehock): How did you determine that there was 250,000 cubic yards of black sand that you estimated on the property?

A. By studying the grades in the subdivision and computing the difference of where the subdi-

(Testimony of R. M. Towill.)

vision would be and the original ground at that time.

Q. How much—do you know how much sand, roughly, was located on the southerly portion of these two lots, 824 and 822?

A. I have no breakdown of that. I treated it as a [59] whole, sir, the whole area.

Q. Well, now, is the ridge or the mountain on the north side of the map, the top side of the map?

A. Going up the hill is towards the north and to the east. This was the side hill here (indicating).

Q. Will you describe where the mountain is, or the ridge is, in relation to Exhibit 16?

A. I would say that the property is on the southwest slope of Makiki Roundtop Ridge.

Q. Now, referring to Exhibit 16, is the ridge the upper part, the left or the right or the lower part of Exhibit 16?

A. The ridge is on the north.

Q. Which is the right side of the map?

A. The top of the map.

Q. The top of the map?

A. The top of the map is approximately north, and the right-hand side of the map can be called the easterly side of the property, or the southeasterly side of the property, and this ridge extends on up to the top of Mt. Tantalus in a northeasterly direction.

Q. Was the sand deposit greater, in depth, as you go up the incline?

A. Yes; as you went towards the upper end of

(Testimony of R. M. Towill.)

the property, there was a greater volume of sand, per square foot, [60] than there was on the lower edge of the property.

Q. On the lower edge of the property, about how much sand was there, per square foot?

A. I would have to compute that.

Q. Well, was it substantial?

A. To give you an illustration, the lower end of the property, the elevation was approximately 450 feet. At the top of the property, the northerly end of it, the elevation was 600 feet. In other words, there was 150 feet difference in elevation from the bottom of the property to the top of the property.

Now, the roads were laid out so that they would gradually go up, but when the complete excavation was done, I think at the top of the property there was a cut of somewhere in the neighborhood of 70 feet, and at the lower end of the property there was a cut probably of 12 to 20 feet. I would have to refer to the engineering drawings to give you those figures exactly, sir.

Q. After the excavation was done and the terracing, and the property subdivided, there was still an incline, was there not, from the southern part to the northern part of the property?

A. That is correct, yes.

Q. And about what was that incline?

A. I would say in the neighborhood of probably 20 feet, [61] I estimate. I can give you the exact figure by referring to my engineering drawings, sir.

Mr. Chehock: That is all.

(Testimony of R. M. Towill.)

The Court: Very well, you may be excused.

Mr. Padgett: Your Honor, I would like to ask one or two more questions.

Redirect Examination

By Mr. Padgett:

Q. You asked about a road across the Hasegawa property, whether it was necessary for the purpose of quarrying. Was that road also necessary for the purpose of subdivision? A. Yes, sir.

Q. How wide a road did you have to put in, under the requirements of the City Planning Commission? A. A width of 32 feet.

Q. Was there any other way to get a 30-foot, or a 32-foot road in there, except by crossing the Hasegawa property? A. No, sir.

Mr. Padgett: That is all.

Mr. Chehock: That is all.

The Court: Very well. You may stand aside, sir.

(Witness excused.)

The Court: I understand that that is to be withdrawn and a copy to be furnished, mark it—— [62]

Mr. Padgett: Marked with the same color, your Honor.

The Court: And you will supply respondent's counsel with the copy?

Mr. Padgett: Yes, I will, your Honor.

Mr. Gowans, please.

LOUIS L. GOWANS

was called as a witness by and on behalf of the petitioners, and, having been first duly sworn, was examined and testified as follows:

The Clerk: Will you state your name, please, sir?

The Witness: Louis L. Gowans.

Direct Examination

By Mr. Padgett:

Q. What is your occupation, Mr. Gowans?

A. I am Executive Engineer of the Honolulu Gas Company.

Q. Did you own some property on Makiki Roundtop, in Honolulu? A. Yes, sir.

Q. What was the first piece of that property which you acquired, and when?

A. Well, the first piece we acquired up there was on—was under an agreement of sale, Lot 824. I think that was the number, approximately three acres.

Q. Did you subsequently get title to it? [63]

A. We subsequently got title to that.

Q. Is that the property on which your home is located?

A. That is the property on which our home is located.

Q. The other piece—is that lot 822?

A. 822.

Q. Will you tell us about your negotiations with

(Testimony of Louis L. Gowans.)

the Honolulu Construction and Draying Company, with relation to that property?

A. Yes. Knowing the property surrounding that, when they had removed this black sand, I was aware that these two lots contained black sand, and I had known Mr. Bush for a long time, and I had kidded with him about—"When are you going to buy my lot," for a good many years that we held this land, and he would say, "Well, we are not ready for that yet. Some day, maybe we will make you an offer," that was as near negotiations as we ever got; but in 1944, he approached me with the idea of buying the lower portion of the lot.

Q. Both or one?

A. Both lots, they were not usable, not being used, and in the condition they were in, they were useless, for any purpose that I could see; but I didn't think the value was going up any more, and I felt that it was useless to hold them any longer, if somebody would buy them; and since they used black sand, there was a quantity of black sand [64] on the land, I thought that probably they would be the logical purchasers, and their offer, or my desire to sell, was consummated in a contract.

Mr. Chehock: Now, your Honor, the witness is using the word "sale," here and I don't like to make an objection on the ground that it is a conclusion, but I take it that the testimony may be his method of describing the situation that way, but I don't want to be understood, by not objecting, that I admit that there was a sale.

(Testimony of Louis L. Gowans.)

The Court: The Court is aware of that, and we will bear that in mind. I assume you can cover the matter on your cross-examination.

Mr. Chehock: Yes.

Q. (By Mr. Padgett): What was the original proposition in 1944, Mr. Gowans?

A. The original proposition was to divide the two lots into two portions. One portion that was adjacent to the highway, that could be used, and another portion that was of no use to me, but which did contain sand, and H. C. and D. agreed that they would buy it at 40 cents a square foot, the exact area to be determined by a survey.

Q. What steps did you take towards carrying out—towards accepting that proposition?

A. Well, at that time, I did not have title to Lot 822; [65] I was buying it under an agreement with the Territory, and in order to make a sale, I went to the Land Commissioner, and asked him if we could sell this land to H. C. and D. by meeting the requirements of building a house and paying the balance due on the land. We had gotten to the stage where we were going to make the sale, and then the attorney told us the limits on the use of this land were stipulated by the Land Department, the Land Commissioner, that it would be necessary to get his permission before we could make the sale. This permission was denied——

Q. That was handled by——

A. ——and the sale was not made.

Q. You wrote the Land Commissioner?

(Testimony of Louis L. Gowans.)

A. That's right.

Q. And you got a reply?

A. I got a reply that was not favorable.

Q. Then what was the next thing that you did after that?

A. Well, the next thing, Mr. Bush came to me with the idea that possibly by working out a subdivision on this land—a subdivision for this land, and a quarrying and access road into it, we might be able to—in the process of creating a subdivision, be able to remove some sand off of the lot, not the total quantity, but some sand, and still leave the land usable for house lots, which seemed to be [66] the Land Department's desire.

The Court: Did 824 have the same restrictions on sale as 822 had?

A. I don't know. My deed did not mention the restrictions, but the deed to the Geers, who acquired it from the Government, may have required that, I am not certain, but it definitely was in the patent for 822.

Q. Do you still own both of those lots?

A. No, I do not. I own a portion of them.

Q. It has been subdivided and you have sold off lots?

A. Well, I sold the whole thing at one sale.

Q. (By Mr. Padgett): And that is the lower portion——

A. The lower portion of these two lots.

Q. Did Mr. Bush make you a proposition, at

(Testimony of Louis L. Gowans.)

that time, with respect to doing this thing by virtue of removing the sand and making a subdivision?

A. The agreement we entered into provided merely that he would buy this land, if it were possible. I think that he still felt that, if it were worked out as a subdivision, and the land eventually used for house lots, that the Land Commissioner would not object to H. C. and D. owning it during the transition period from removing the land and preparing it for subdivision and eventually putting it on [67] the market for house lots; and so the agreement we first entered into was that first we would sell the property to H. C. and D., if Mr. Bush could clear that matter; if not, we would sell the sand to Mr. Bush, take the property and sell it.

Mr. Chehock: I didn't get the last part.

The Witness: It amounted to a 2-part sale, the land and the sand. If Mr. Bush could not buy the whole thing, the sand developed in the creating of the subdivision would be sold to Mr. Bush, and then I could sell the land any way I saw fit.

The Court: That is what was done?

A. That is what was done.

Q. (By Mr. Padgett): Now, when you originally——

Mr. Chehock: Now, your Honor, I would object to the conclusion that that was what was done. What was done was a legal transaction entered into.

The Court: Well, whatever it is, they followed the second section of the contract, whether it is a lease or a sale, or whatever it might be, that is

(Testimony of Louis L. Gowans.)

what they did. They didn't convey the title to the land.

The Court: You retained the title to the [68] land?

A. That is correct.

Q. (By Mr. Padgett): Handing you this agreement of September 4, 1945, which is Exhibit 5 attached to the stipulation, is that the agreement which you entered into with the Honolulu Construction and Draying Company?

Mr. Chehock: Your Honor, that instrument has been stipulated.

Mr. Padgett: Yes, I know, but I just wanted to identify it.

The Witness: Yes, that is correct.

Q. (By Mr. Padgett): Now, Mr. Gowans, I call your attention to the fact that there is one alternative—I mean, that there is in the alternative, the removal of the sand and the subdivision proposal, there is a five-year limitation on that. Can you tell me whose idea that was?

A. Well, I was anxious to get my money, and would have liked the term as short as possible. Mr. Bush was faced with the problem of how fast he could use it, and how much equipment he had available to make his operation as economically as possible, and we arrived at the five-year period as being—and the price he was to pay, as possibly a good a solution for both of us as we could arrive at.

Q. Mr. Gowans, after the agreement was en-

(Testimony of Louis L. Gowans.)

tered into, [69] what was the next thing that was done in connection with this transaction?

A. Well, after the agreement was signed, Mr. Bush was allowed to start on the work of removal of the sand until the title for Lot 822 was cleared, and in order to clear that, we had to build a house.

That was right after the war, the materials were very hard to get, but Mr. Bush, being in the construction business, thought that he could get the materials and build this house and satisfy the terms of the agreement with the Government; and he had the plans drawn up, which I approved, and he did build the house, the title was cleared, and I received a land patent from the Government for Lot 822.

Q. And it was after that, that they started removing the sand?

A. It was after that that they actually started.

Q. This house was built on an area of Lot 822, not within the sand area?

A. That is correct.

Q. I take it that Honolulu Construction and Draying Company built this house at their own expense, and charged back to you their expense as they removed the sand? A. That is correct.

Q. Now, with respect to the modified agreement of May 19, 1950, can you tell us how it came about that that [70] modification was entered into?

A. Well, Mr. Bush was not taking off the quantity that he originally thought he would remove during each of the five years, and it looked as though he was going to have difficulty in meeting

(Testimony of Louis L. Gowans.)

the final day, and he suggested that we extend the time. He was willing to make the payments required in five years, but wanted more time to actually complete the work; so there was an additional extension of time for the completion of the work.

Q. I note that that agreement which is an exhibit attached to the stipulation, the payments were set at $2,040 a month, and H. C. and D. was obligated to pay that amount of $2,040 a month; is that correct?

A. Yes. I had made certain commitments based on this contract with H. C. and D., and the extension of time and the payments made it necessary to me to make some other arrangement about this money, and so H. C. and D. agreed to make the payments to me of $2,040, I think it was, which I was obligated to make to the bank, whether they took the sand out or not.

Q. As a matter of fact, when you originally entered into this agreement with Mr. Bush, did you have any understanding as to how much sand he was going to remove a year?

A. Well, we agreed between us that he would do about one-fifth of the work each year, so the payments would be [71] spread over a five-year period, and he could do the work any way he saw fit.

Q. Along about 1947, did you enter into a note with the bank, by which you obligated yourself to pay $1,050 a month to the bank?

A. That is correct.

(Testimony of Louis L. Gowans.)

Mr. Padgett: That note is attached as an exhibit to the stipulation, your Honor.

Q. (By Mr. Padgett): Now, isn't it a fact that H. C. and D., in March of 1948, commenced to pay you that sum of $1,050 a month, which you turned over to the bank? A. That is correct.

Q. And that situation went on until the new agreement was made in March of 1950?

A. Yes, when the extension was agreed to.

Q. And during that period, while they were paying you $1,050 per month, that was substantially in advance of the amount of black sand that they had withdrawn?

A. I never knew how much black sand they had withdrawn, except that I accepted their reports; I had no check. The only thing I was interested in was that they would remove the 250,000 yards by the end of five years. I was dependent upon the engineer's drawings to determine that quantity. [72]

Q. Mr. Gowans, Exhibit 5, which I have shown you, is in the language of buyer and seller. Was it your conception that you had sold 250,000 cubic yards of black sand?

A. Absolutely. I felt that I had no control over that 250,000 yards after that contract was entered into.

Q. Ultimately, after the sand was removed, you sold the whole subdivision area to someone?

A. That is correct.

Mr. Padgett: That is all, your Honor.

(Testimony of Louis L. Gowans.)

Cross-Examination

By Mr. Chehock:

Q. Mr. Gowans, the reason the payments were made to the bank, these royalty payments—were they made to you and then to the bank, or paid directly to the bank?

A. I am not certain of that. They may have been made to me directly and I paid them to the bank; I am not sure, but I did sign the contract that guaranteed the payments to the bank.

Q. The only reason the bank was involved was because of your dealings in borrowing money from the bank? A. Yes.

Q. Otherwise, the bank would not have been in the picture, at all, would it?

A. No; that is correct. [73]

Q. In other words, in regard to this extension agreement that was entered into in May of 1950, H. C. and D. got no additional sand; I mean, even after that additional year was up, they were only to get the 250,000 cubic yards originally contemplated? A. That is right.

Q. So that the only purpose of the extension agreement was to give them the additional year and the use of the premises in extracting the sand; is that correct?

A. They felt it would be a hardship to have to take it out in five years, and their operations would be more economical if they could extend it a year.

(Testimony of Louis L. Gowans.)

Q. Mr. Gowans, I don't know if you can add anything, or not, but if you can, describe the property in September of 1945, before any excavations were had, at all, that will be helpful to the Court, I wish you would do it.

The Court: The physical aspects of the property.

The Witness: The land, itself, is located on the face of Roundtop Mountain, the mountain southeast of here, and it is fairly uniform slope from the top of the hill to what is called the plains down here at Makiki. The grades, I would think, were about thirty or thirty-five degrees or the slope of that mountain can be determined, if it is very [74] important.

Q. You are describing it now as of September, 1945?

A. That is correct. That is a fairly uniform slope, on a hillside, with a road along the top side of the two lots. That is the only place that the road touches the land, or touched the land at that time.

Q. It would have been possible, would it not, to have built houses on your property, as it was?

A. Well, I had already built a house on the property, where we had access to the road. Which property are you speaking of?

Q. I mean, this Lot 824 and Lot 822, where the black sand was eventually taken out of. If the sand had been left there, could the houses have been built on it? A. Physically or legally?

Q. Well—strike it.

(Testimony of Louis L. Gowans.)

The Court: It would have been physically possible?

A. Physically, it would have been possible, at great expense, to build them there, but you couldn't have met the city's subdivision requirements to have sold the lots, without access from the road.

You have to have water, lights, sewers or cesspools, and sidewalks and roads before you could sell off lots.

Q. In order to—and this project, you did get an easement through a couple of people's property; is that right? [75]

A. We got a thirty-foot—actually, it was deeded to us, eventually, thirty feet, across the Hasegawa property.

Q. That could have been obtained whether the black sand had been removed, or not, could it not?

A. Well, I don't know. It depends on what Hasegawa would have been willing to do.

Q. Well, assuming that they wouldn't have been any worse off—would they?

A. Well, they would have lost the road. It would have split their property.

Q. Well, eventually, they gave it up anyway, didn't they?

A. Yes, they gave it up for a consideration.

Q. If you had given them back the consideration, the same consideration, you could have erected houses on the black sand, without excavating and taking it out of the property, couldn't you?

A. Are you talking about physically?

(Testimony of Louis L. Gowans.)

Q. I am talking about physically or legally. If you had the right of access to the road there, you could have built houses on it legally, as well as physically, couldn't you?

A. Not without taking a road into the property.

Q. I mean taking the road into the property?

A. It would have taken a great deal of [76] grading. Something would have had to be done with the black sand. Even the roads going up the hillside there, why they have got plenty of distance, you can see where they have cut the mountain out to make the road, and they simply had to get rid of the material to get a road into the side of the hill.

Q. Well, now this black sand was all over your property, where they took it off, wasn't it?

A. Well, it was in varying thicknesses.

Q. Varying depths? A. Yes.

Q. And, of course, you knew that if they took the black sand off of your land it would be just an eyesore there and would naturally necessitate terracing it, and fixing it up for residential purposes, did you not?

A. I don't know that I quite understand your question about the eyesore.

Q. Well, describe the property after the sand was excavated and before it was filled in.

A. Well, they had a great deal of heavy equipment in there, moving the sand around, they dug a pit there, where the trucks could drive down in, and the bulldozers worked and removed the sand

(Testimony of Louis L. Gowans.)

and moved it into hoppers where they could load automatically into these trucks to remove it. That was all a part of the operation. Getting these 250,000 [77] yards off—you can't move that quantity of material economically without cutting and grading, and setting up equipment, or moving sand economically—bulldozers and hoppers and pits to drive into, so the trucks could load. That was all a part of the operation.

Q. Just describe the property after the sand was taken out, and before it was filled in. How deep was it, and how much did they have to fill in, and what the size of the hole, and so forth?

A. Well, they discovered a sand that they felt was desirable and they excavated a pit on a portion of the lot where the sand was desirable, and built a road down to that, and from that point they pushed the sand from the balance of the land up to this hole to load their trucks. After they had completed that, they went back into the corner of the land, where the material was hard, and they cut down that to the engineering plan, as Mr. Towill developed, and filled up this hole that they had used for loading the material that they felt was desirable.

Q. Will you describe the size of that hole, before they filled it in?

A. I would think it was probably 50 feet wide, and 60 or 70 feet long, where trucks could drive down in and turn around onto the hopper, and drive out again.

(Testimony of Louis L. Gowans.)

Q. How deep was it? [78]

A. Well, measured from what?

Q. I beg your pardon?

A. Measured from what?

Q. Up to where it would eventually have to be filled in.

A. How much lower was it than the eventual grade?

Q. Yes.

A. I would think about 20 feet, possibly.

Q. And so after they had excavated the sand and had this big hole there, they did whatever was necessary to fill in this hole? A. Yes.

Q. And what else did they do?

A. They finished the final grading and put in the improvements, the roads, the water mains, street lights, and so on.

The Court: Whatever was required for the subdivision?

A. They agreed to do the minimum requirements to meet the subdivision laws of the city and county. That was their agreement. They submitted these plans and got approval and H. C. and D. did put in the improvements, did meet the subdivision requirements and got the approval of the city. [79]

Q. (By Mr. Chehock): In making your original deal, you knew that it cost more to excavate and quarry all of these 250,000 cubic yards of black sand on your property, it would probably mean the digging of a hole there, and so forth. You contemplated then, from the beginning, that the property

(Testimony of Louis L. Gowans.)

would need to be put back, and the hole filled up, and so forth, in order to put it in ultimate shape for a subdivision, that was what you contemplated from the beginning, that they would use the premises and you knew that, and that is the reason you made a part of the deal the fact that they would put the property back into position where you didn't have a hole, and where they could improve it and terrace it, and put on the subdivision?

Mr. Padgett: Your Honor, I am going to object to that question. I got lost about halfway through.

The Court: Yes, your question is a little bit involved, Mr. Chehock. However, if the witness followed the question, I will permit him to answer.

The Witness: I don't know that I fully understand it but certainly the improvements for the subdivision was a part of the price that H. C. and D. agreed to pay for the 250,000 yards of sand that they bought.

Q. (By Mr. Chehock): And that necessitated grading?

A. That necessitated grading and doing everything to [80] meet the subdivision requirements. I might also add that that necessarily followed the plans for the grades and terraces that had to be submitted, or that the city had approved, in order to get that final approval; the plans that had been submitted to them had to be carried out.

Q. Mr. Gowans, you paid the taxes on this property for the years 1946, 1947, 1948, 1949, 1950, 1951 and 1952, yourself, did you not? A. Yes.

(Testimony of Louis L. Gowans.)

Q. Then you paid the taxes—that is, the real property taxes, including whatever taxes were placed on the property, which of necessity included the sand, during that period?

A. I don't know that there was a tax on the sand; I have never heard of it.

Q. The sand is a part of the land?

A. I would say that the contract called only for 250,000 yards of sand at forty cents a yard, plus this work that they did on the subdivision; it did not call for them to pay taxes during these five years, if that is what you mean.

Q. And the extension agreement of May, 1950, there was an additional requirement placed on H. C. and D., one of which was to pay the taxes; and so, on February 2, 1953, you were reimbursed for the taxes you had paid in 1950, 1951, [81] and 1952; is that correct?

A. I think that is correct, but I am not sure. I think the taxes started at the time the agreement extension was negotiated, and I think they were to pay the land taxes from that time on until the——

Mr. Padgett: I will stipulate that that is correct. The document speaks for itself, and makes provision that H. C. and D. will pay the taxes for those three years, the pro rata amount.

Q. (By Mr. Chehock): And that the taxes shown as having been—for which the petitioner was reimbursed in Paragraph T of the stipulation of facts, was actually reimbursed—the actual re-

(Testimony of Louis L. Gowans.)

imbursement was made on February 2, 1953; is that correct? A. I think so.

Mr. Padgett: Yes.

The Court: Well, very well then. The record will show it is so stipulated.

Mr. Chehock: Your Honor, I am going to offer into evidence a photostatic copy of the 1947 returns of both the petitioners. Does counsel have any objection?

Mr. Padgett: Will the Court give me just a moment?

The Court: Yes.

Mr. Padgett: No objection. [82]

The Court: There being no objection, Respondent's Exhibits A and B are received in evidence.

(The documents above referred to were marked Respondent's Exhibits A and B, respectively, and were received in evidence.)

Mr. Chehock: That is all, your Honor.

Redirect Examination

By Mr. Padgett:

Q. Mr. Gowans, 1947 was the first year you received any payments for the sand, wasn't it?

A. I think that is correct.

Q. And commencing with the first payment you received, you consistently treated it in your tax return as long-term capital gain? A. Yes.

Q. Mr. Gowans, you were asked several ques-

(Testimony of Louis L. Gowans.)

tions about a hole in the ground. Did you have anything to do in connection with the actual excavation that H. C. and D. did? A. No, sir.

Q. When you started out, did you have any idea that they might dig a hole in the ground?

A. I had the idea that they would get the sand, but I had no idea how they would get it.

Q. You were not concerned with that? [83]

A. I was not concerned with that.

Mr. Padgett: I think that is all. Oh, yes, there is one other thing.

Q. (By Mr. Padgett): In September of 1945, the Hasegawa property had already been used to take out the black sand, hadn't it? A. Yes, sir.

Q. If you had run this road across the Hasegawa property, as it may have been suggested, you would have run into a wall?

A. I think so. I am not certain of that, but they had excavated in there and they more or less did the same thing in removing the sand; they dug a hole where the trucks could run in and load, and out.

Q. Could you have put a road on those premises and subdivided them, without doing grading?

A. No, sir.

Mr. Padgett: That is all.

(Testimony of Louis L. Gowans.)

Recross-Examination

By Mr. Chehock:

Q. And this excavating and digging of this hole you talk about in this other property—was that done prior to 1945?

A. They are still taking sand off of the Hasegawa property. They took it off before that; they have taken it [84] off since and are still taking some off.

Q. Then if you knew that they dug this hole in the property adjoining yours, you had reason to know that H. C. and D., in taking the sand then from your property would probably do the same thing, did you not?

A. Well, I didn't know how they planned to do it. I have no objection to their doing it the most economical way they could do it.

Mr. Chehock: That is all.

The Court: No further questions?

Mr. Padgett: No further questions.

The Court: Very well, you can stand aside.

(Witness excused.)

Mr. Padgett: Your Honor, I have one more witness, who will be rather short.

The Court: Very well, let's finish up before we recess.

Mr. Padgett: Mr. Sayres is the next witness.

C. D. SAYRES

was called as a witness by and on behalf of the petitioners, and, having been first duly sworn, was examined and testified as follows:

The Clerk: Will you state your name, please?
The Witness: C. D. Sayres. [85]

Direct Examination

By Mr. Padgett:

Q. Mr. Sayres, what is your occupation?

A. I am treasurer of the Honolulu Construction and Draying Company.

Q. Pursuant to my request, have you brought with you the ledger sheet relating to the payments on the Gowans' sand contract? A. I have.

Q. Were those sheets prepared under your direction? A. They were.

Q. And they are in your custody?

A. Yes.

Q. Mr. Sayres, can you tell us in what manner you carried the payments made to the Gowans, how they were placed in your books, or how they were characterized in your books?

A. There are three different accounts set up in the books, and one was headed, "Referred Royalties," and one was, "Prepaid Royalties," and one was, "Accrued Royalties."

Q. What were the deferred royalties?

A. The deferred royalties were when we assumed the obligation of Mr. Gowans on the note that he had at the bank.

(Testimony of C. D. Sayres.)

Q. How much was that?

A. That was forty-eight thousand and some odd dollars. [86]

Q. That was put on the debit side of your——

A. That was put on the debit side of our ledger.

Q. What did you put as a credit?

A. Accounts payable.

Q. What was the next category of royalties?

A. That was "Prepaid Royalties."

Q. What did they consist of?

A. They consisted of these advances that we made to Mr. Gowans of $1,050 a month.

Q. How about the house?

A. The house was set up as a prepaid royalty.

Q. How about the $2,040 per month?

A. The $2,040 was applied on deferred liabilities, deferred royalties.

Q. That was applied to scale down deferred royalties, as you went along? A. Yes.

Q. Now, then, what were the accrued royalties?

A. That was a funny situation. Sometimes, in taking out the black sand—and at that time we would remove enough black sand that we would owe Mr. Gowans more than we had advanced him; so then, in the bookkeeping, we had to set up the accrued royalties, and then when we quit taking it, we would show we had overpaid him.

Q. Were there substantial periods of time when you would [87] say you had overpaid Mr. Gowans?

A. Yes, there were.

(Testimony of C. D. Sayres.)

Q. When did you finish charging off the $19,000 that you expended in building this house for him?

A. That was finished in May, 1948.

Q. When did you start the $1,050 payments to him?

A. That was from March 1, 1948, to March 31, 1950.

Q. So that there was an overlap between the time—you hadn't finished charging off the house before you started the $1,050?

A. That is correct.

Q. Mr. Sayres, did you treat the Gowans matter on your books any different from the way you did your other quarrying operations?

A. No. We had various accounts that we were paying royalties to, such as the Bishop Estate, the Campbell Estate, and the Territories, and we have a ledger sheet with eight columns with accrued royalties, and the various royalties and we put the Gowans' account with the others.

Q. Was there any reason for that, Mr. Sayres?

A. No. That was the procedure we had always followed with other firms or outfits that were being paid royalties by us, we just continued in the same method when we handled Mr. Gowans' account.

Q. Well, now, Mr. Sayres, you have used the word [88] "royalty" in in your testimony. What precisely, do you mean by that term?

Mr. Chehock: Now, your Honor, I object to that question as leading; and, furthermore, asking for

(Testimony of C. D. Sayres.)

a conclusion that this witness is not competent to testify to.

Mr. Padgett: Your Honor, here is a man who used the term "royalty" and——

The Court: For whatever it may be worth, I am going to permit the witness to answer.

The Witness: We had contracts that we were paying royalties to on a tonnage or yardage basis, and when the Gowans' contract was signed, we set up the account identically then as we had set up the other accounts.

Mr. Padgett: I think that is all.

Cross-Examination

By Mr. Chehock:

Q. Mr. Sayres, Mr. Padgett made inquiry and asked you how these payments were recorded on your books, and I think you testified that they were recorded as royalty payments in three different categories, deferred, accrued and prepaid; is that right? A. That is correct.

Q. Will you carry that one step further, and show how that became a part of your manufacturing operations? Were these payments, then, in fact, a part of your raw materials' inventory?

A. Indirectly, yes; we did not put it into inventory until we had actually removed the sand.

Q. Then what did you do?

A. Then we would credit the proper account, de-

(Testimony of C. D. Sayres.)

pending on whether it was deferred on prepaid or accrued.

Q. And so all that went into these three royalty accounts eventually became a part of your materials inventory; is that not true?

A. That is right.

Q. And, therefore, is reflected as a part of the cost of goods manufactured?

A. That is right.

Mr. Chehock: Will you mark this as an exhibit?

The Clerk: Exhibit C for the Respondent and Exhibit D for the Respondent are marked for Identification.

(Respondent's Exhibits Numbers C and D were marked for Identification.)

Q. (By Mr. Chehock): I hand you Exhibit C for Identification, Mr. Sayres, and ask you if you have looked over the minutes of the directors of the Honolulu Construction and Draying Company, Ltd., for this whole period from 1944 on up through 1952, and ask you if Exhibit C reflects the correct wording of all [90] the minutes that you found in the Minute Book regarding the Gowans' transaction? A. That is correct.

Mr. Chehock: The Respondent offers into evidence Exhibit C, consisting of three sheets.

The Court: No objection, Mr. Padgett?

Mr. Padgett: No objection.

The Court: There being no objection, Respondent's Exhibit C is received.

(Testimony of C. D. Sayres.)

(The documents heretofore marked Respondent's Exhibit C was thereupon received in evidence.)

Q. (By Mr. Chehock): Mr. Sayres, you were subpoenaed here—the Honolulu Construction Company was—to bring in all of the records that you have here regarding the Gowans' transaction, and do you have here in your possession letters written by the Honolulu Construction and Draying Company to Mr. Gowans during the period that the payments were made to him? A. I have.

Q. Also letters written to the bank, and a letter written to the Board of Water Supply?

A. I do.

Q. I hand you Exhibit D, and ask you if the copies of the letters contained in Exhibit D are correct copies of that [91] portion of the letters reflected by the various instruments included in Exhibit D?

Maybe it would be helpful to go letter by letter here, Mr. Sayres.

It will not take too long, your Honor.

The Court: I was just wondering if you could not get them in evidence, and let him check through them after we recess, for correction if there has been any typographical errors. That is the only thing that he may find, isn't it?

Mr. Chehock: I would like to say to the Court that we are not putting in evidence or letters written to Mr. Gowans. Most of these covered letters

(Testimony of C. D. Sayres.)

written towards the end of the year, 1947, 1948, 1949, 1950 and 1951, and that will let the Court see the manner in which the Honolulu Construction and Draying Company handled the accounts, I think.

The Court: Very well. I think the easiest way to handle that would be to offer them in evidence, subject to check by the witness for any typographical errors or corrections. Isn't that satisfactory?

Mr. Padgett: That is all right with me, your Honor, but I would like to ask a couple of questions on voir dire.

Q. (By Mr. Padgett): Mr. Sayres, these are not all of the records—are not all of the letters you wrote to Mr. Gowans? A. No.

Q. Do you have the copies of the other letters which you wrote with you? A. I do.

Q. You have copies of the whole lot?

A. I have the whole file here.

Q. Those are copies? You don't have the originals?

A. No, the original went to Mr. Gowans.

Q. But do you have other copies available for your files? A. No.

Mr. Padgett: Your Honor, I have some very strong objections to put in carefully selected excerpts of long, lengthy correspondence, and I am going to have to offer the whole thing, and ask the Court's permission to allow me to make additional copies, inasmuch as the originals apparently have been kept by Mr. Gowans. I would like, with the Court's permission, to make copies of those which

(Testimony of C. D. Sayres.)

Mr. Chehock is not offering, so that I can get those, and get all of the correspondence in.

The Court: You would have no objection to that, would you?

Mr. Chehock: I have no objection. However, I would like to say this: Counsel has stated they have been [93] carefully selected. I think he will find that all of them used, in substance, the same words, used the word "royalty," and in effect contain, in substance, the same thing, we will be very happy, but I think it is just putting in useless and repetitious type of evidence by putting the whole thing in evidence here.

The Court: Very well. I will receive Respondent's Exhibit D in evidence, with the understanding that the witness can take it and check it for typographical errors; and I will also permit Mr. Padgett, on behalf of the petitioners, to offer as an exhibit such additional letters from the files as the parties can agree upon, I take it.

Mr. Padgett: Very well, your Honor.

Mr. Chehock: You mean today?

The Court: Yes. They are here?

Mr. Padgett: They are here, and I will offer them.

The Court: And you can withdraw them and make copies.

Mr. Padgett: Has the witness identified these sufficiently?

The Court: He can glance through them and see if they are the copies that he wrote.

(Testimony of C. D. Sayres.)

Mr. Padgett: I am not going to raise any objection on the matter of identification.

Mr. Chehock: I might state that, prior to [94] this trial, two days ago, I gave counsel for the petitioners an exact copy of everything that had been offered here, and Mr. Sayres also saw them, and I don't see——

The Court: I don't think there is any question about that. It is purely a question of correcting any typographical errors that may have crept in.

The Witness: These are all typical letters that I did write during that period.

The Court: Very well, Respondent's Exhibit D is received in evidence.

(The document heretofore marked Respondent's Exhibit D for identification was received in evidence.)

Mr. Chehock: I might say that Exhibit D, your Honor, includes twelve separate letters.

The Court: Very well.

Mr. Chehock: That is all.

The Court: Very well, you may inquire, Mr. Padgett.

Redirect Examination

By Mr. Padgett:

Q. Mr. Sayres, do you have with you the copies of the letters which you sent to Mr. Gowans?

A. In that file, yes.

Q. I notice one or two of them are attached to notes. [95]

(Testimony of C. D. Sayres.)

A. Those are just the notes that were given to me to write the letters.

Q. Those are interoffice communications?

A. That is all.

Mr. Padgett: Your Honor, I will offer those which have not been offered; I have no segregation of those which have and have not been offered, and those that haven't been have not been put in as a part of D.

The Court: That will be——

Mr. Chehock: Your Honor, I am wondering if this case is going to continue after dinner——

The Court: No, no. We are going to receive this after the petitioners' next exhibit, which will be Petitioners' Exhibit 17. You gentlemen run through them and select the letters which are not included in your Exhibit D, Mr. Chehock, and I will permit the Clerk to receive in evidence, as Petitioners' Exhibit 17, copies of the letters, the other letters from the file, in addition to those.

Mr. Chehock: Do that right now?

The Court: Yes, you can do it right now, if you want to. We will finish the case before you do that.

Mr. Padgett: That is all the questions I have.

The Court: Any further questions?

Mr. Chehock: No further questions. [96]

May I glance at my notes a minute?

Q. (By Mr. Chehock): Mr. Sayres, can you state what the cost of improvements were on this property, exclusive of the building?

A. The total cost of the improvements was $69,254.23.

(Testimony of C. D. Sayres.)

The Court: Does that show the cost of the building?

A. I have the cost of the building here, and it was $19,332.81.

Q. (By Mr. Chehock): And that house cost is reflected on your books on or about October, 1946?

A. That is right.

Mr. Chehock: That is all, your Honor.

The Court: Very well.

(Witness excused.)

Mr. Padgett: We rest.

Mr. Chehock: The Respondent rests, but we would like permission to withdraw our exhibit for photostating.

The Court: Withdraw all exhibits?

Mr. Chehock: I will take C and D.

The Court: Leave is given to withdraw Exhibits C and D, and substitute photostatic copies therefor, and it is understood that Petitioners' Exhibit 17 will be supplied to the Court and marked as such, after you [97] gentlemen have selected the letters that go into that exhibit.

Mr. Padgett: May we ask leave thereafter to withdraw and substitute copies?

The Court: Yes. Leave is given to withdraw those exhibits, and substitute photostatic copies or typewritten copies, either, for that matter.

Now, gentlemen, if that is all, what is your pleasure in regard to the time for filing briefs?

Mr. Padgett: Your Honor, because of the length

of the evidence in this case, I have made inquiries as to the transcript, and it will probably be thirty days, so I would like sixty days.

The Court: Sixty days?

Mr. Chehock: Does your Honor want simultaneous or concurrent briefs?

The Court: Well, if you desire more time than that, we will make them consecutive.

Mr. Chehock: I would like more time.

The Court: How much time would you like, after that? That will be sixty days for the Petitioners' brief. How much time would you like following that?

Mr. Chehock: Sixty days.

The Court: Will thirty days be enough time for your reply brief? [98]

Mr. Padgett: Yes.

The Court: Petitioners' original brief to be filed on or before September 22, the Respondent's brief on or before November 22, and thirty days from that.

The Clerk: December 22nd for the Petitioners' reply brief.

The Court: Petitioners' reply brief on or before December 22.

Now, gentlemen, if there is nothing further in connection with this case, we will stand in recess until tomorrow morning at 10:00 o'clock.

(Whereupon, at 12:45 o'clock p.m., the hearing in the above-entitled petition was closed.)

Filed August 30, 1954. T.C.U.S. [99]

[Title of Tax Court and Cause.]

CERTIFICATE

I, Ralph A. Starnes, Chief Deputy Clerk of the Tax Court of the United States, do hereby certify that the foregoing documents, 1 to 10, inclusive, constitute and are all of the original papers and proceedings on file in my office as called for by the "Designation of Contents of Record," including exhibits I, I-A and II thru XV, attached to the Stipulation of Facts, Petitioners' Exhibits 16 and 17, admitted in evidence and Respondent's Exhibits A thru D, admitted in evidence, in the proceeding before the Tax Court of the United States docketed at the above number and in which the petitioners in the Tax Court proceeding have initiated an appeal as above numbered, and entitled, together with a true copy of the docket entries in said Tax Court proceeding, as the same appear in the official docket book in my office.

In testimony whereof, I hereunto set my hand and affix the seal of the Tax Court of the United States, at Washington, in the District of Columbia, this 20th day of August, 1956.

[Seal] /s/ RALPH A. STARNES,
Chief Deputy Clerk, Tax
Court of the United States.

[Endorsed]: No. 15247. United States Court of Appeals for the Ninth Circuit. Louis L. Gowans and Helen T. Gowans, Husband and Wife, Petitioners, vs. Commissioner of Internal Revenue, Respondent. Transcript of the Record. Petition to Review a Decision of the Tax Court of the United States.

Filed: August 27, 1956.

Docketed: August 31, 1956.

/s/ PAUL P. O'BRIEN,
Clerk of the United States Court of Appeals for the Ninth Circuit.

In the United States Court of Appeals
for the Ninth Circuit

No. 50427

LOUIS L. GOWANS AND HELEN T. GOWANS,

Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

STIPULATION

It is hereby stipulated that the exhibits in the above-entitled cause may be considered by the Court in their original form and need not be reproduced in the printed record.

/s/ FRANK D. PADGETT,
Attorney for the Petitioners.

/s/ CHARLES K. RICE,
Assistant Attorney General,
Attorney for the Respondent.

[Endorsed]: Filed November 1, 1956, C.C.A.